the sustainable trade initiative

proforest

EU regulation on deforestation-free products

Recommendations for a forest positive impact

March 2022

Introduction

The EU regulation on deforestation-free products signals a step change in Europe's response to the pressing global challenge of deforestation, and the willingness of member states to change the terms of trade for deforestation-risk commodities consumed within Europe. We welcome efforts to halt deforestation in commodity supply chains. We understand the complexity of the issue and the need to consider how the entire supply chain will respond.

The approach taken in the regulation will provide a 'clean' supply of product to the European market. However, it misses the opportunity to provide incentives for restoration and preventing deforestation as it does not recognise deforestation mitigation efforts in production areas that are proactively tackling the root causes of deforestation, but have not yet achieved zero-deforestation.

Moreover, instead of increasing investment in forest protection and stopping deforestation, this approach could disincentivise forest positive investment by companies sourcing forest-risk commodities for products for consumption in the EU. It may also result in the unintended consequence of excluding smallholder suppliers from supply chains, negatively impacting their livelihoods. We need to build on the positive foundation of the EU regulation, and not miss opportunities to identify and work to mitigate the risks of on-going deforestation.

In this paper we put forward a proposal consisting of two compatible steps for modifying the regulation, which could address these risks and incentivise action to achieve deforestation-free products and forest restoration by sourcing companies and by producer countries. We make the case that these aims will be most effectively achieved if done at sub-national jurisdictional level where local authorities, farming communities and commodity buying companies are involved and aligned. This can deliver sustainable land management and stronger forest protection that covers all commodities irrespective of where they are consumed, and where EU consumption can create market pull for stronger and faster action to achieve zero-deforestation.

Authorship and acknowledgements

This report was co-developed by IDH and Proforest, with support from Duncan Brack for the research and drafting.

We wish to thank the following persons from IDH and Proforest for their contribution:

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Risks

The aim of the proposed EU deforestation regulation is to ensure that forest risk commodities and products entering the EU market are free of deforestation. While this should have some effect on global levels of deforestation, there are some key risks:

1. **Diverting risk to other markets**
2. **Lack of reward for progress towards deforestation-free**
3. **Incentivising exclusion of high-risk areas**
4. **Losing leverage to improve conditions in high-risk areas**
5. **Disincentivising purchasing from smallholders**
6. **Benchmarking overlooks differences between low and high-risk areas**
7. **Diplomatic tensions on definition of low and high-risk areas**

It is possible that EU supply chains will be cleaned up while simply diverting commodities associated with deforestation to other export markets. This simply leaves the root causes of deforestation in the countries of origin largely untouched – including poverty, and poor standards of landscape governance and forest law enforcement. Deforestation will continue.

Similarly, the proposed regulation offers no reward for sources (areas or suppliers) that are making progress in reducing levels of deforestation, a process that can take years. It takes a binary approach: commodities are either deforestation-free, in which case they are allowed access, or they are not, in which case they are excluded. This leaves the potential for further damage to farmers' livelihoods (in particular smallholders) and increased levels of deforestation as commodities are exported to alternative markets with lower, or no, standards.

This situation extends into the future. If a particular farm becomes subject to deforestation at any point after the end of 2020 – the cut-off date in the regulation – none of the forest risk commodities listed in the regulation produced on that farm can ever be exported to the EU, regardless of the extent or duration of the deforestation or any efforts made subsequently to restore forest cover on that farm.

The system creates an incentive for companies placing forest risk commodities on the EU market to avoid high-risk sources and suppliers, since they need to undertake greater efforts to verify the absence of deforestation, and instead to favour low-risk sources, which may be areas where forests are adequately protected, or – perhaps more likely – areas which were already deforested before the end of 2020.

Any leverage that companies sourcing from high-risk areas previously exerted over conditions there could be lost. EU supply chains may become 'cleaner' but no overall progress in combating deforestation would be made. This is particularly true where the EU is not the main global market for the commodity in question (which is the case for four of the six commodities listed in the regulation: cattle products, palm oil, soy, and timber) and accordingly exercises less influence over export markets than other sources of demand.

On top of this, the requirement to collect information on the commodities, including the geographic coordinates of the plot of land on which they have been grown, and evidence that they are free of deforestation and legally produced, will be costly and problematic to implement, in terms of collecting the information required and transmitting it through the supply chain. This seems likely to encourage buyers to source commodities from large-scale producers who are likely to be better equipped to provide reliable data, rather than smallholders.

The benchmarking system introduced under the regulation is an interesting innovation, but in our view represents a missed opportunity. In practice the differences in the requirements for companies sourcing from countries, or parts of countries, that fall into the three levels of risk – high, standard, and low – are not significant. Companies sourcing products from low-risk countries will be subject to a simplified due diligence procedure, which includes only the information collection requirements and not the risk analysis or risk mitigation steps – but information collection includes the need for plot-level geolocation data and evidence of legal and deforestation-free production, which is the most challenging step.

Companies sourcing products from high-risk countries will not face any additional requirements at all compared to standard-risk countries; they will simply be subject to an increased frequency of checks by EU competent authorities. It is an open question, therefore, whether being assessed as a high-risk source will make any real difference in practice. There is, however, the possibility of some reputational damage; it is not difficult to imagine, for instance, companies sourcing from low-risk countries using that fact to promote their own products at the expense of products originating from high-risk countries. It is also not yet clear to what level of geographical granularity the benchmarking system will work – i.e. what is meant by 'parts' of countries.

In addition, the benchmarking process itself is likely to cause political and diplomatic problems. The idea of the EU formally deciding which producing countries are high, standard or low risk – with unclear input from the countries themselves (the regulation provides only for them to be consulted where the level of risk is raised) – is not likely to be welcome to producer countries and will not recognise any actions or success in combatting deforestation if it did not result in zero-deforestation by 2020.

Opportunities to address risks

Some of the likely negative impacts are mentioned in the impact assessment released by the European Commission to accompany the regulation, including the increased costs faced by producers, particularly smallholders, and the possibility of buyers switching to low-risk sources. The regulation itself contains some measures aimed at tackling them, including a commitment to negotiate partnerships with producer countries, and a review of the impact on farmers, particularly smallholders.

We believe that there are greater opportunities to address these risks and ensure that the regulation incentivises forest positive activity in producing jurisdictions by modifying the framework as it is negotiated between EU Council members and members of the European Parliament.


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We set out below a potential alternative set of measures, building on the framework constructed by the regulation while enabling a continuous improvement strategy. We retain the market-based approach to due diligence which is at the core of the regulation which includes the important incentive of access to the EU market. We propose two possible measures that may be implemented in two different steps:

A. Step A is the basic core of our proposed approach. It offers a means of building into the regulation a mechanism to deliver support to jurisdictions making genuine commitments to reduce their levels of deforestation.

B. Step B involves a bigger modification of the regulation to provide a stronger incentive for high-risk jurisdictions to tackle deforestation. Step B could be added to Step A; it does not stand on its own.

These are outlines of proposed measures, put forward for discussion; we recognise that they need further development and debate.

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A / Transitional jurisdictions

Offer support to high-risk areas that are improving forest and land governance, and recognise Transitional Jurisdictions in the benchmarking process against a time bound deforestation-free road map

Transitional jurisdictions

A new category is created in the benchmarking process, called (provisionally) 'transitional-risk' and benchmarking is explicitly permitted at jurisdictional level. A 'jurisdiction' is an area within the administrative boundaries of sub-national or national governments, where administrative or legal measures can be applied and where multiple stakeholders are collaborating to address the root causes and drivers of deforestation at the level of the jurisdiction.

Under this measure, after a jurisdiction is identified as high-risk, the EU offers it the opportunity to move to the new 'transitional-risk' level in the benchmarking process. This would unlock support to tackle deforestation, building, where possible, on existing jurisdictional initiatives. Financial, technical and capacity-building support could be provided in a variety of ways and should include elements specifically tailored to promoting compliance with the regulation, including, for example, assistance with establishing traceability systems, collecting farm-level geolocation data, ensuring compliant commodities are segregated, and so on.

This support should be provided both by the EU and its member states (including through the EU's planned Forest Partnerships) and by companies sourcing from the area, as part of the risk mitigation process included in the regulation. This additional risk mitigation requirement on companies should help to ensure that they remain invested in the area, working with their suppliers to reduce deforestation over time.

This 'transitional-risk' status would only be made available to jurisdictions which undertake commitments to a time-bound roadmap of actions to reduce and eventually eliminate deforestation over a defined and short period. The roadmap could also include a requirement to restore forest cover to the levels existing at the end of 2020, which would maintain the spirit of the current deforestation-free baseline whilst allowing for restoration where forest had already been lost. These commitments would need to be approved by the relevant regulatory authorities for the jurisdiction in question. Clearly, fulfilment of commitments would need careful monitoring, and if satisfactory progress is not made in line with the agreed roadmap, the area would be moved back to high-risk status.

The offer of 'transitional-risk' status should be limited to jurisdictions that have already shown progress in reducing deforestation levels in recent years and putting appropriate policy and governance frameworks in place, including, for example, multi-stakeholder deliberative processes providing input to decision-making for farmers, forest communities, civil society and the private sector alongside the authorities. This would avoid awarding this status to jurisdictions which in reality have no intention of taking appropriate action, but would recognise and incentivise those that have already started to tackle deforestation.

Roadmap of activities

The range of activities to be included in the roadmap would be a matter for negotiation between the EU and producer countries and sub-national governments. They could be linked to EU Forest Partnerships or relevant elements of the EU Green Deal. They should focus not only on reducing deforestation, but should also include forest-positive strategies, including promoting forest landscape restoration, introducing sustainable agroforestry systems, improving farmers' livelihoods and enabling them to implement sustainable farming practices.

This approach aims to reinforce the many jurisdictional approaches to combating deforestation currently under way, including many supported by the EU, for example through the EU-REDD Facility.[1] Adopting jurisdictional approaches helps to reduce overall deforestation by ensuring that forest law enforcement is aligned with land use planning, agricultural investment and social and economic development in the producing regions – hence tacking some of the underlying drivers of deforestation.

[1] These approaches aim to apply measures across an entire landscape or jurisdiction rather than focusing on individual drivers of deforestation, such as single crops. A 'landscape' is likely to include a mosaic of interacting land uses and management practices within a geographical area, often defined by the boundaries of a natural ecosystem. A 'jurisdiction' is an area within the administrative boundaries of sub-national or national governments, where administrative or legal measures can be applied.

Building on the Voluntary Partnership Agreement approach

It also borrows from the idea behind the Voluntary Partnership Agreements (VPAs) negotiated between the EU and timber-exporting partner countries under the EU's Forest Law Enforcement, Governance and Trade (FLEGT) initiative. VPA partner countries undertake to implement improvements in governance and law enforcement, including legal and policy reforms, with support from the EU, to reduce the incidence of illegal logging.

The important point is that rather than simply identifying an area as high-risk, a mechanism is provided at the same time to lower the level of risk in the future, with benefits for any country importing forest risk commodities from that area, not simply the EU.

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Expanding the due diligence statement

We also propose a relatively minor change to the 'due diligence statement', which, under the proposed regulation, companies will be obliged to submit before their products are placed on the EU market or exported. This states that the products meet the criteria, or at least that there is a negligible risk of them not doing so, and confirms that due diligence was carried out and that no or only negligible risk was found. It must contain information on the company, the products and the country of production and all plots of land of production. These statements will be entered in a register that will be available to competent authorities in EU member states and, in an anonymised form, to the public.

We propose to add a requirement that due diligence statements must specify the risk level of the country or jurisdiction of origin to the due diligence statement. This would help to reinforce the impact of the benchmarking process, focusing companies' attention on risk levels. It would also allow the European Commission and the public to monitor the sources of forest risk commodities entering the EU market and to determine any trends in, for example, companies switching away from high-risk and towards transitional-risk areas of origin.

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B / Variable information requirements

Vary the information requirements on the source of commodities by risk level, and reframe the deforestation-free requirement for transitional-risk jurisdictions

Under Step A, the support offered by EU authorities and by companies sourcing from transitional-risk areas as part of their risk mitigation obligations should help to provide incentives for jurisdictions to transition from high to low risk.

But there will still be an incentive for companies to source from low-risk areas, where – under the current text of the regulation – there are no risk assessment or mitigation requirements. This is addressed in a second step (Step B) by varying the information required on the origin of the commodities, and by accepting that a low level of deforestation may still be associated, for a limited period of time, with commodities from transitional-risk areas.

Low-risk areas

Instead of requiring geolocation information for the plots of land of every consignment of forest risk commodities placed on the EU market, the information needed would be varied with the level and risk of deforestation in the jurisdiction in question. For both low-risk and transitional-risk areas, the requirement for information on the origin of the commodities would be changed from the plot ot land to the jurisdiction.

This clearly makes sense for low-risk areas, where the level of current deforestation is negligible. This is in line with the approach taken in the **Accountability Framework** and some certification schemes. It creates an incentive for all actors in the area in question – farmers, communities and companies in the supply chain – to work together to ensure the avoidance of deforestation, since if any one actor permits deforestation, the entire area is affected. It supports existing jurisdictional approaches to tackling the problem. It reduces the cost of implementing the geolocation requirement for the 'first mile' in smallholder production systems, offering smallholders a stronger market position than is likely under the regulation.

To ensure that companies sourcing from low-risk areas monitor risk levels, the requirement to conduct risk assessment and risk mitigation should be reinstated, alongside the information collection requirement (under the current proposals, only information collection is required). If the risk is genuinely low and remains low, requiring risk assessment and mitigation will not be onerous steps, but they are good practice in applying the concept of due diligence.

In effect, this collapses the low-risk and standard-risk levels in the current regulation into one level. The risk assessment and risk mitigation steps of the due diligence process would then also be carried out at the jurisdictional level, the latter in cooperation with the local authorities.

Companies should still have the option, if they wish, of providing the geolocation information by plot of land or farm polygons, and demonstrating deforestation-free by an earlier target date. This may help them in marketing their products.

Transitional-risk areas

For transitional-risk areas, the same change in the information collection requirement – from plot of land to jurisdiction[2] – and including risk assessment and risk mitigation would be made, in order to ensure that the commodities are not being sourced from high-risk areas.

However, the assumption is that low levels of deforestation might still be taking place in transitional-risk areas. Our proposal recognises that it is important for companies to engage with these areas to reduce deforestation, rather than switch to sourcing only from low-risk areas. We therefore propose that the regulation temporarily accepts the risk of low levels of deforestation associated with products from these jurisdictions while the roadmap is in place and being satisfactorily implemented, – i.e. as long as the jurisdiction remains in the transitional-risk level.

A cut-off date must be agreed as part of the roadmap, setting a clear target date by which the jurisdiction must achieve deforestation free (with the option of requiring restoration of forest cover to 2020 levels). Once deforestation has been halted, the jurisdiction can be classified as low-risk. The jurisdiction will then continue sticking to the cut-off date identified in its roadmap, which would likely be later than 2020.

As with the low/standard risk areas, companies should still have the option, if they wish, of providing geolocation information by farm, village or municipality and demonstrating deforestation-free by an earlier target date. This may help them in leveraging sustainable product marketing strategies.

[2] *For transitional-risk areas, the responsibility to define the traceability requirements would ultimately rest with the local stakeholders in the jurisdiction (i.e. to farm, cooperative), with traceability to that jurisdiction as a minimum.*

We recognise that this represents a significant change to the framework set out in the regulation. It rests mainly on the 'continuous process of improvement' approach to due diligence, as set out in the UN Guiding Principles to Business and Human Rights, and various OECD guidance documents[3] (and which is reflected in the EU proposal for a Directive on Corporate Sustainability due diligence)[4]. Under this approach, companies are not expected to solve the problems in their supply chains immediately, but to work with their suppliers to address the problems over time.

In this case, that means using the reward – access to the EU market – as an incentive for suppliers to work to reduce deforestation rather than encouraging importers simply to abandon these sources. Deforestation levels in source areas should be reduced regardless of the destination of commodity exports, with, accordingly, wider benefits for forests. This proposal also provides a route back to compliance for areas which have experienced deforestation after 2020, which would otherwise – under the current proposed regulation – never be able to export to the EU. It is designed to reward engagement rather than abandonment.

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High-risk areas

Companies sourcing from high-risk areas, where levels of deforestation are not negligible, and where no agreed roadmap for reform is in place, would still be required to provide detailed geolocation information, together with evidence that their commodities had not been associated with deforestation after the 2020 cut-off date. Thus, good actors in high-risk areas would not be excluded from the EU market. It is suggested that the polygons of farms should be provided, rather than the geolocation of the plot of land. This is a more complex – though more useful – process and should increase the incentives on jurisdictions to develop plans which would allow them transitional-risk status.

[3] *OECD Due Diligence Guidance for Responsible Business Conduct*
[4] *https://ec.europa.eu/info/sites/default/files/1_1_183885_prop_dir_susta_en.pdf*

Visualization of the proposed measures through a hypothetical example

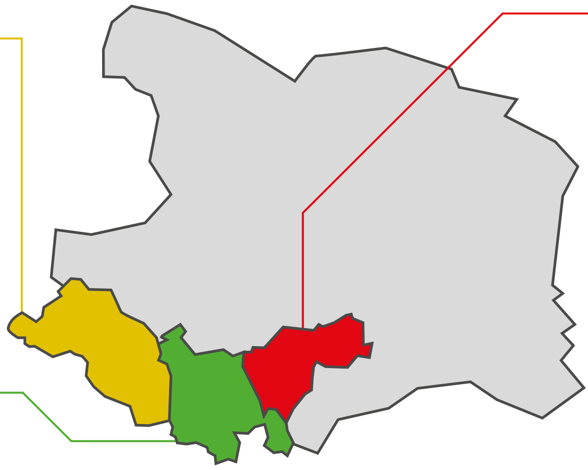
Illustrative example: **risk rating at jurisdictional level**

Region A – Transitional-risk:

- Still forest left
- Deforestation: **3%/year**
- Deforestation drivers: **cocoa, rubber, timber**
- But, Region A has committed to "no deforestation by XX date", hence classified as "transitional-risk"

Region B – Standard risk:

- All forests have been replaced with cocoa
- Deforestation rate almost close to zero due to the absence of forests



Region C – High-risk:

- Still forest left
- Deforestation: **5%/year**
- Deforestation drivers: **cocoa, rubber, timber**
- No jurisdictional commitment on deforestation, hence classified as "high-risk"

Illustrative example: **company and jurisdictional obligations linked to risk rating**

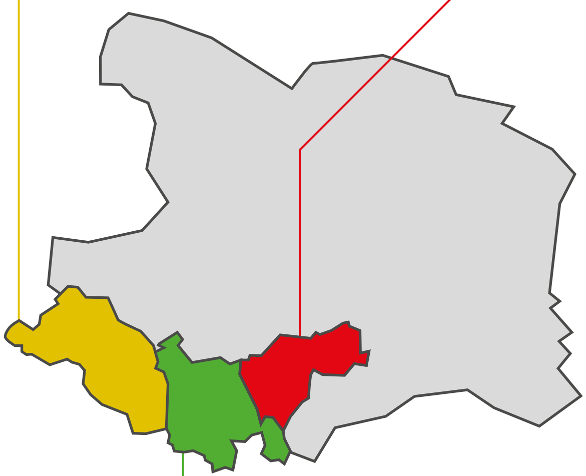
Region A – Transitional-risk:

Company due diligence process

- Companies have to have traceability to the region level
- They have to prove that they are engaged in a jurisdictional program, and that the program aims to eliminating deforestation in the region by XX date.
- They have to contribute financially to reducing deforestation in the region
- Risk analysis at the jurisdictional level
- Risk mitigation (including provision of support) at the jurisdictional level

Requirement for the jurisdiction

- The region needs to have a target on the elimination of deforestation by XX date
- Progress against the target is reported upon on a yearly basis
- Support from EU and member states



Region B – Standard risk:

Company due diligence process

- Companies have to have traceability to the region level
- Information collection, including origin by jurisdiction
- Risk analysis at the jurisdictional level
- Risk mitigation at the jurisdictional level
- No deforestation after 2020

No requirement for the jurisdiction

Region C – High-risk:

Company due diligence process

- Companies have to have traceability to the farm level, with farm polygon data
- They have to prove that the farms they're sourcing from:
  - Are not located in a protected area (legality)
  - Are not in an area that was deforested after 31 Dec 2020
  - Risk analysis at the farm level
  - Risk mitigation at the farm level
  - Increased checks by EU authorities

No requirement for the jurisdiction

Proposed changes in summary

The table compares the existing regulation text with the proposal in this paper. Changes flowing from Step A are indicated in **blue**, those from Step B in **orange**. Black text and green bullet points indicates no change from existing proposed regulation.

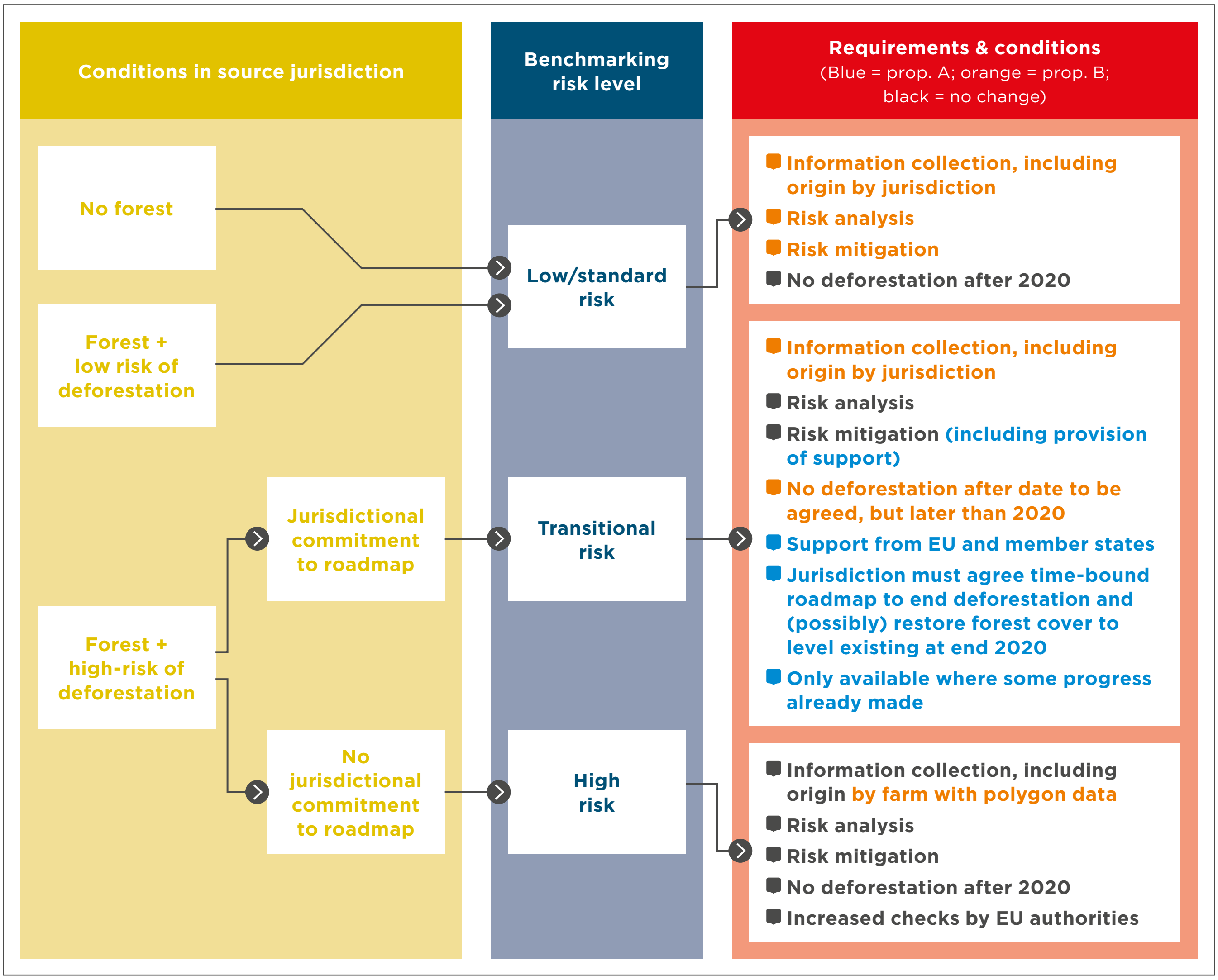
Existing regulation		This proposal	
Risk level	**Requirements and conditions**	**Risk level**	**Requirements and conditions**
Low	▪ Information collection, including origin by plot of land ▪ No deforestation after 2020		Not applicable – combined with Standard risk
Standard	▪ Information collection, including origin by plot of land ▪ Risk analysis ▪ Risk mitigation ▪ No deforestation after 2020	Low/standard	▪ Information collection, including origin by jurisdiction ▪ Risk analysis at the jurisdictional level ▪ Risk mitigation at the jurisdictional level ▪ No deforestation after 2020
		Transitional	▪ Information collection, including origin by jurisdiction ▪ Risk analysis at the jurisdictional level ▪ Risk mitigation ongoing (including provision of support) at the jurisdictional level ▪ Support from EU and member states ▪ Deforestation-free after date to be agreed, but later than 2020 ▪ Jurisdiction must agree time-bound roadmap to end deforestation and (possibly) restore forest cover to level existing at end 2020 ▪ Only available where some progress already made
High	▪ Information collection, including origin by plot of land ▪ Risk analysis ▪ Risk mitigation ▪ No deforestation after 2020 ▪ Increased checks by EU authorities	High	▪ Information collection, including origin by farm with polygon data ▪ Risk analysis ▪ Risk mitigation ▪ No deforestation after 2020 ▪ Increased checks by EU authorities

In Conclusion

The EU regulation is a welcome step to addressing deforestation in commodity production. But in its current form it will not prevent deforestation, it will simply divert it from the European market. Companies will be incentivised to move their sourcing to larger production units and lower risk areas that deforested prior to 2020. Smallholder producers, in particular, will be hit by the costs and complexity of detailed geolocation requirements, potentially excluding them from markets essential to their livelihoods.

As such, the regulation misses the opportunity to also provide support and incentives to high-risk areas that are committed to become deforestation-free. We offer a mechanism to implement the EU Due Diligence requirements that supports jurisdictions to address the root causes of deforestation, conserve and restore forests and provides a transition pathway to zero-deforestation.

Appendix I.
Sourcing decision tree



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