

## **Brief Summary**

Forests are an essential carbon sink; without protecting the world's forests, it will be impossible to keep global warming to 1.5°C above preindustrial levels. Forests also provide habitat to over 80 per cent of the world's terrestrial biodiversity. The livelihood of millions of people and especially Indigenous communities is dependent on forests. However, global deforestation continues at an alarming rate, accelerating species extinction and climate change and threatening human rights. Global trade in agricultural commodities is a major driver of deforestation. As the world's second largest importer of forest-risk commodities (FRCs), the EU's responsibility is to avoid deforestation in its supply chains. The EU is currently discussing various approaches to do so.

In the context of this publication, we have analysed, compared and evaluated five different approaches. These include the EU Regulation on deforestation-free products, the EU Sustainable Corporate Governance initiative, reform of EU trade agreements, Sustainable finance and voluntary corporate commitments. To identify Strengths, Weaknesses, Opportunities and Threats (SWOT) of each approach, we have conducted expert interviews as well as an extensive literature review.

Our analysis finds that to varying extents, all options can contribute to reducing EUdriven deforestation. Voluntary corporate commitments as they exist today are not sufficient to address the problem. The EU should pursue a combination of several more binding approaches to address both the specific problem of imports linked to deforestation as well as the broader systemic drivers of corporate responsibility, finance and trade. While the EU Regulation on deforestation-free products appears to have the potential to be the most effective in preventing deforestation linked to the importation of specific high-risk products, the current legislative proposal contains several loopholes that would significantly reduce its effectiveness. A strong EU legislation on environmental and human rights due diligence is needed to complement the product-specific approach of the Regulation on deforestation-free products. Through comprehensive sustainable finance frameworks, the EU should also contribute to a shift of international financial flows away from activities that drive deforestation and towards more sustainable land-use. EU trade agreements could contribute to reducing deforestation if they are reformed to include enforcement mechanisms that ensure compliance with environmental and labour commitments. Furthermore, EU action should be embedded in a cooperative international strategy that engages producer countries as well as other large consumer markets.

## **Imprint**

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## **Acronyms**

AA Association Agreement

AFI Accountability Framework Initiative

CBD Convention in Biological Diversity

**CGF** Consumer Goods Forum

CITES Convention on International Trade in Endangered Species of Wild Fauna and Flora

**CMS** Convention on Migratory Species

COP26 26<sup>th</sup> United Nations climate change conference

**CSRD** Corporate Sustainable Reporting Directive

DG AGRI Directorate-General for Agriculture and Rural Development (EU Commission)

**DG ENV** Directorate-General for Environment (EU Commission)

**DG GROW** Directorate General for Internal Market, Industry, Entrepreneurship and SMEs

**DG JUST** Directorate-General for Justice and Consumers (EU Commission)

**DG TRADE** Directorate General for Trade (EU Commission)

**EGD** European Green Deal

**ENVI** Committee on the Environment, Public Health and Food (EU Parliament)

**EP** European Parliament

**EU** European Union

**EUTR** EU Timber Regulation

FDI Foreign Direct Investment

**FEFAC** European Feed Manufacturers' Federation

**FPIC** Free, Prior and Informed Consent

FRCs Forest-risk commodities

FTAs Free trade agreements

**IDH** Sustainable Trade Initiative

ILO International Labour Organization

**INL** Legislative initiative procedure

INTA Committee on International Trade (EU Parliament)

NDCs Nationally Determined Contributions

NFRD Non-Financial Reporting Directive

NGO Non-governmental organisation

**NYDF** New York Declaration on Forests

**OECD** Organisation for Economic Co-operation and Development

SAN Sustainable Agriculture Network

SDGs Sustainable Development Goals

SEG SF Sustainable Finance Technical Expert Group

SFDR Sustainable Finance Disclosure Regulation

SMEs Small and medium-sized enterprises

**TFA** Tropical Forest Alliance

**TFEU** Treaty on the Functioning of the European Union

**TSD** Trade and Sustainable Development

**UNEP** United Nations Environmental Programme

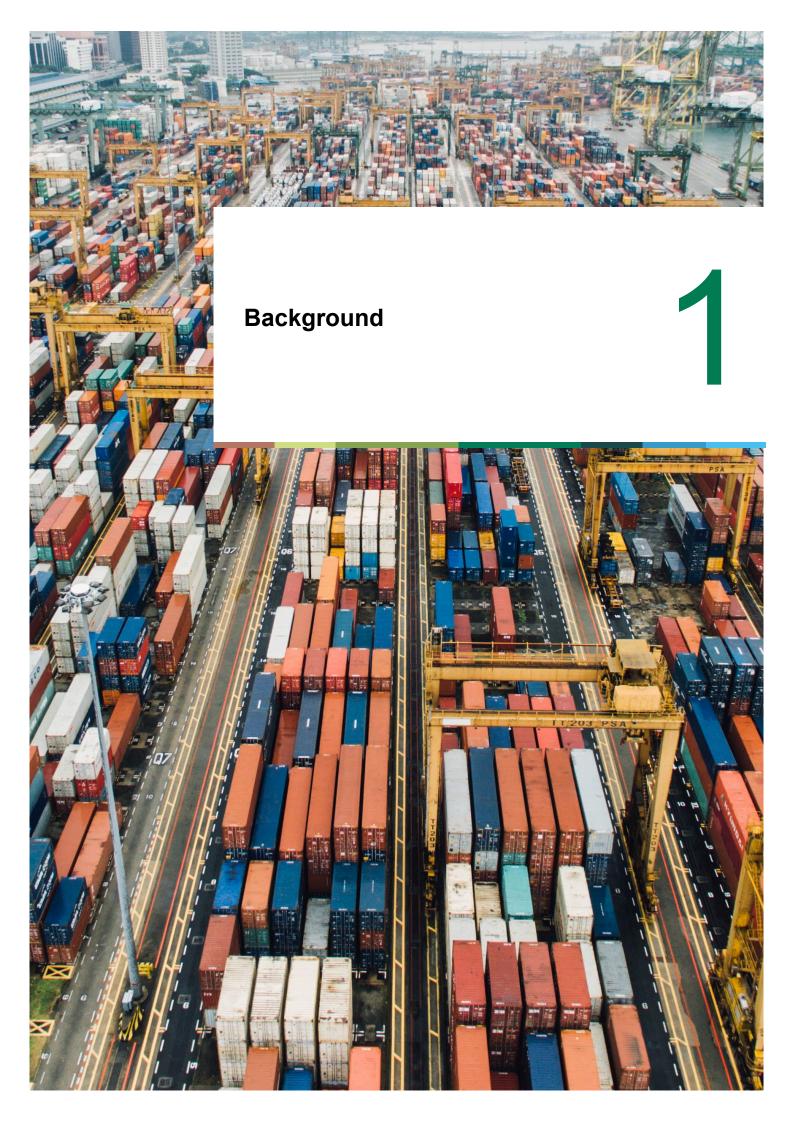
**UNFCCC** United Nations Framework Convention on Climate Change

WTO World Trade Organization

**ZDCs** Zero-deforestation commitments

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#### Deforestation - an urgent global problem

Deforestation and forest degradation continue at an alarming rate. This has serious consequences for biodiversity, the climate, and human rights. Forests host over 80 per cent of the world's terrestrial biodiversity. (FAO 2020b) They provide vital ecosystem services such as purification of water, enhancing water storage capacity of the soil or improving air quality. Forests function as an essential carbon sink and provide oxygen. Additionally, around one third of the world's population closely depend on forests and forest products. Forest loss endangers the livelihood of many Indigenous peoples as they depend to a particularly high degree on forests. Since 1990, an estimated area of 420 million hectares of forest have been cleared worldwide for conversion to other land uses. (FAO 2020a) In Latin America and the Caribbean, between 1990 and 2020, 138 million hectares of forest cover were lost (Quiroga 2021), further fueling the climate crisis. On the other hand, forest protection and restoration are very important to mitigate it. The destruction of forests for industrial agriculture often comes along with human rights violations, such as expropriation and displacement of Indigenous peoples and local communities from their customary lands, dispossession of their resources, loss of access to food, clean water and traditional medicines, threats and violence. (Acevei and Shimray 2021)

#### The EU's responsibility for impacts of deforestation in supply chains

Global agricultural trade is a major driver of deforestation. International trade in agricultural commodities, mainly beef and vegetable oil, such as soy and palm oil, causes the emission of more than one billion tons of CO<sub>2</sub> per year due to tropical forest loss. (Pendrill et al. 2019) The EU is the world's second largest export market for forest-risk commodities after China (TRASE 2020) and thereby responsible for 10 per cent of global deforestation caused mainly by the consumption of products such as soy, palm oil, livestock products (like beef, leather and poultry), rubber, timber, cacao, maize or coffee – the so-called forest-risk commodities (FRCs). (European Commission 2019b)

The EU's responsibility is to address the impacts on forests, ecosystems, climate and human rights associated with its trade. However, apart from laws to regulate illegal trade in timber and fish or trade of conflict minerals, there is currently no regulation governing the importation of agricultural commodities into the EU that drive degradation and deforestation of ecosystems with high ecological and social value. In July 2019, the European Commission (EU COM) adopted the *Communication on stepping up EU action to protect and restore the world's forests* (European Commission 2019a). It recommends establishing a multi-stakeholder platform to provide a forum for exchange and to promote certification schemes that encourage 'deforestation-free' commodities to combat imported deforestation. Moreover, the EU COM has also committed to minimising the risk of deforestation and forest degradation associated with commodity imports into the EU by law. (European Commission 2019b)

In this publication, we evaluate different political instruments to address deforestation and ecosystem degradation. We analyse five demand-side regulatory policy options at the EU level for their strengths, weaknesses, opportunities, and threats (see Methodology in chapter 2). Based on the individual evaluation, we then formulate policy recommendations for an effective strategy to halt deforestation.

Our analysis focuses on deforestation in the economic and political block Mercosur (Argentina, Brazil, Paraguay and Uruguay), a region where deforestation is particularly prevalent and exports to the EU play a significant role.

#### Deforestation in Mercosur due to agricultural production

Brazil has had the second highest tree cover loss globally in the past 20 years. (Global Forest Watch 2022) This development was supported by state policies that from the 1970s onwards made Brazil one of the largest agricultural producers and exporters worldwide. (Spring 2018) Deforestation is particularly serious in Brazil, but similar dynamics exist in the other countries of Mercosur as well. Soybean production and cattle ranching are the main drivers of deforestation in Mercosur. It is estimated that cattle ranching cause 80 per cent of deforestation in the Amazon region. (Global Witness n.d.) There, ranching is used as a simple way to claim cleared land. The land later is often transformed into monocultural soybean production. Many land use changes are associated with land grabbing and illegal deforestation. In the past years, those practices have not been closely monitored or punished by the Brazilian government, but - on the contrary - encouraged. (Philips 2020) Institutions that monitor deforestation and illegal clearings have been hindered in their work and not been equipped with adequate resources. As of 2018, 173 million hectares of pasturelands were degraded in Brazil. (Feltran-Barbieri and Féres 2021) Instead of restoring these landscapes, it is more attractive for industrial agricultural production to deforest more land. This has been politically underpinned through the construction of roads, tax incentives, subsidised rural credits, and agrarian reform projects. Meanwhile the productivity of livestock production remains low. (Barreto 2021)

#### Box 1: Definition of forests, deforestation, net- and zero deforestation

More than 800 definitions of **FORESTS** are recognised by the United Nations Environmental Programme (UNEP). The Food and Agriculture Organization (FAO) defines forests as "land with tree crown cover (or equivalent stocking level) of more than 10 per cent and area of more than 0.5 hectares (ha). The trees should be able to reach a minimum height of 5 meters (m) at maturity in situ." (FAO 1998) Additionally, each country can define forests differently within these criteria. (European Forest Institute 2013)

**DEFORESTATION** is the loss of natural forest, depletion of tree crown cover to less than 10 per cent (FAO 1998), because of: i) conversion to agriculture or other non-forest land use; ii) conversion to a tree plantation; or iii) severe and sustained degradation. Therefore, different indicators are used: one regarding the loss of tree cover and the other in terms of change in land use.

Changes within the forest that lower the production capacity and negatively affect the stand or site are categorised as **FOREST DEGRADATION**.

ZERO DEFORESTATION means that no forest areas are cleared or converted at all.

**ZERO NET DEFORESTATION**, on the other hand, allows the clearance or conversion of forests when this is compensated by an equal area that is replanted elsewhere. What an equal area of forests means in terms of carbon, biodiversity, cultural or ecosystem value, is debated. (Lake and Baer 2015)

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<sup>&</sup>lt;sup>1</sup> Only Russia had a higher relative tree cover loss.

**ILLEGAL DEFORESTATION** occurs when deforestation takes place against the laws and regulations of the country of harvest. Therefore, to halt illegal deforestation does not imply halting deforestation in general.

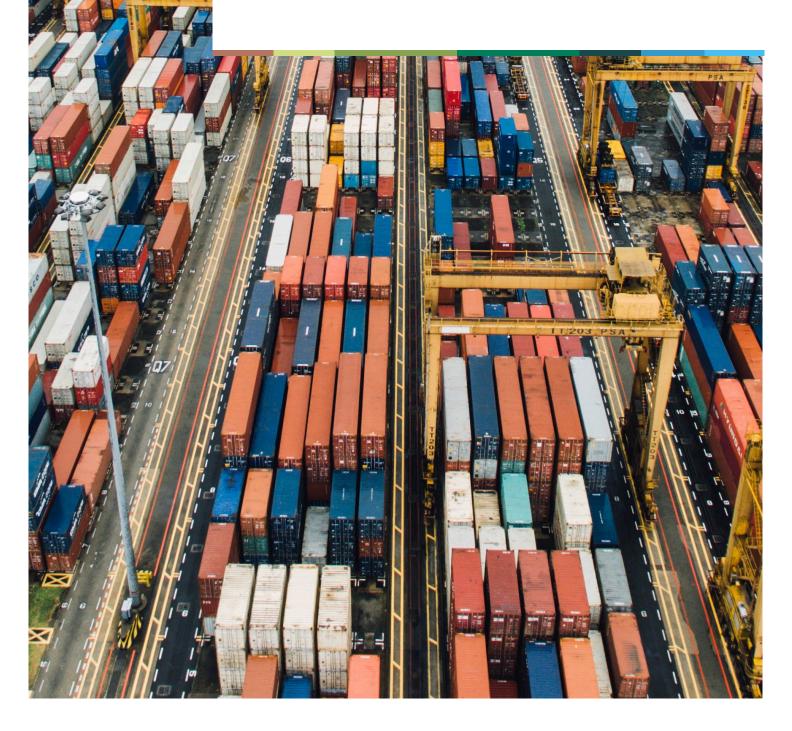
While deforestation of the Amazonian rainforest has received a high level of public attention and action against deforestation has been taken by public and private actors, other South-American biodiverse ecosystems as the Brazilian Cerrado or Argentinian Gran Chaco are under increasing pressure. Over the last 20 years, vast areas of native vegetation of the Cerrado, the most biodiverse savanna ecosystem worldwide, and the Gran Chaco, the largest dry forest in South America, have been replaced by soybean cultivation and livestock pastures. (Global Forest Watch 2021) Many ecosystems are close to critical ecological tipping points, after which the ecosystems are irreversibly lost.

In addition, there are serious social consequences of deforestation and the destruction of ecosystems, which often remain unnoticed by the international public. Cases of labour abuses and precarious working conditions on cattle farms, illegal loggers working in slavery-like conditions, and forced labour can be associated with deforestation for agricultural production in Brazil. (Teixera 2021)Additionally, land conflicts, especially between local communities and big corporates often become violent and reinforce the oppression of marginalised people. (Food First Informations- und Aktions-Netzwerk 2018)

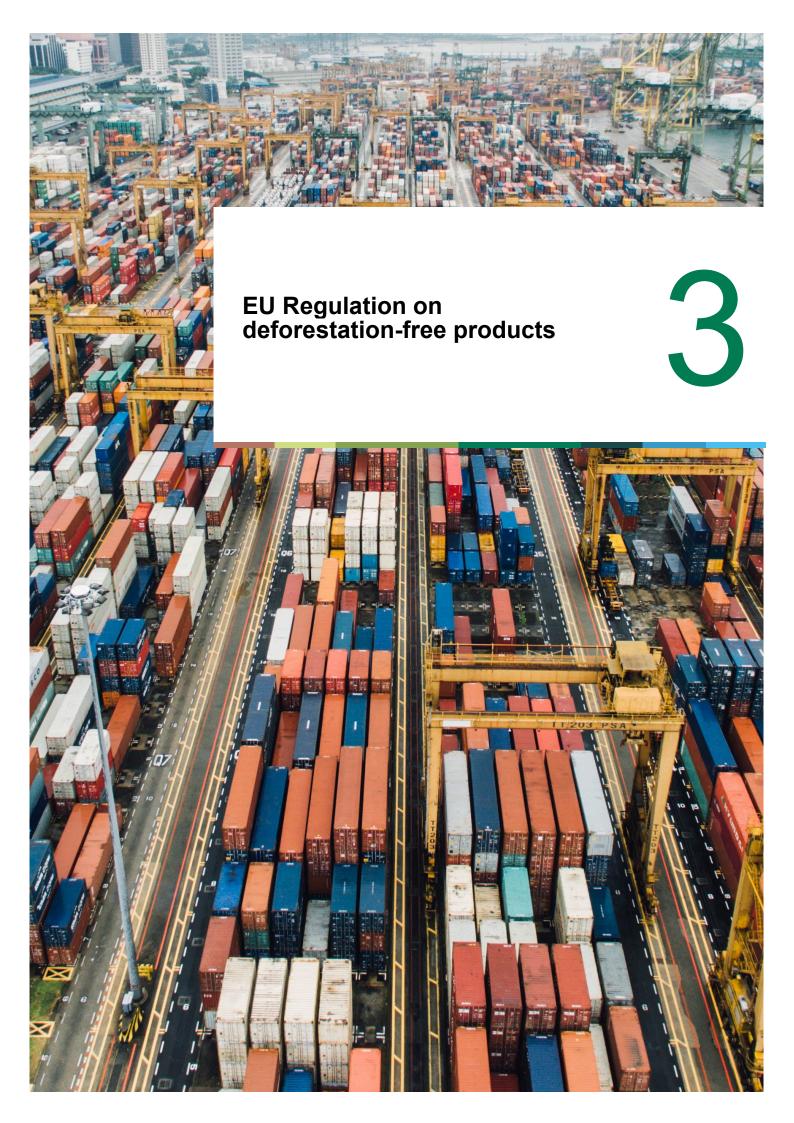


# Methodology

2



To evaluate the effectiveness of each approach to halt deforestation in EU supply chains, we conducted a SWOT analysis. A SWOT analysis is a common instrument for strategic planning, which allows comparison, selection, and combination of different actions. A SWOT analysis focuses on a specific goal and evaluates the **Strengths**, **Weaknesses**, **Opportunities** and **Threats** of a particular action regarding this goal, in our case to halt deforestation linked to EU agricultural supply chains in Mercosur. Prior to the SWOT analysis we identified relevant stakeholders, whose position we considered for the SWOT analysis. Sources for the SWOT analysis have been an extensive literature review as well as qualitative interviews with relevant stakeholders and experts. However, the concepts and proposals do not necessarily reflect their views but are educated evaluations of those by the Germanwatch project team.



# 3.1 What is the EU Regulation on deforestation-free products?

In July 2019, the European Commission (EU COM) adopted the *Communication on stepping up EU action to protect and restore the world's forests*. (European Commission 2019a) Therein, the EU COM among others, made a commitment to minimise the risk of deforestation and forest degradation associated with commodity imports into the EU. This was the first step towards a regulation to curb EU-driven deforestation. (European Commission 2019b)

The EU COM reinforced this commitment in the European Green Deal (EGD) (December 2019), the Farm to Fork strategy (May 2020) and the 2030 Biodiversity Strategy (May 2020). Subsequently, the European Parliament (EP) drafted a legislative initiative report (Burkhardt 2020) in October 2020 seeking proposals from the EU COM on an EU legal framework to reduce deforestation caused by EU imports. (European Parliament 2020)

The EU COM's proposal for a Regulation on deforestation-free products was published on 17 November 2021. (European Parliament 2021a)

The main objective of this regulation is to close the EU market to commodities and products that caused deforestation, leading to biodiversity loss, greenhouse gas emissions or displacement of local communities including Indigenous peoples who rely on forest ecosystems. The regulation is thus intended to promote deforestation-free supply chains.

Before placing forest-risk commodities (FRCs) like soy, beef, palm oil, timber, coffee and cocoa and their processed products on the EU market or exporting them from the EU, operators and large traders would be required by the proposed regulation to carry out comprehensive, effective and continuous due diligence to prove that their products are not linked to deforestation or forest degradation.

Depending on the size of the company and the country of origin of the commodity, the scope of the due diligence obligation differs. Small and medium-sized enterprises (SMEs) are required to provide information on their suppliers and the sources of raw materials and products, including information demonstrating that no deforestation or forest degradation has taken place and that legal requirements are met. Large enterprises additionally must carry out a risk assessment in step two of the due diligence process. If the risk assessment determines that there is a non-negligible risk, companies must take mitigation measures in the third step of the process. The EU COM also proposes a benchmarking system to assess countries of origin and their level of risk of deforestation and forest degradation driven by the FRC. If a company is placing commodities on the EU market from a country or parts of countries identified as low risk, they only have to carry out a simplified due diligence and do not have to carry out a risk assessment and risk mitigation.

Compliance with due diligence requirements is to be controlled by competent authorities and the number and types of controls will vary according to the size of the business. Where there is a high risk of non-compliance, authorities are required to take immediate action, such as suspending the placing on the market of the commodities and products. In case of infringements, the regulation

contains a list of sanctions. These include fines as well as seizure of the commodities, products and revenues or the prohibition of economic activities for the concerned company.

A review two years after the law comes into force will revise the law and might extend its scope to include more commodities and/or ecosystems.

## 3.2 SWOT analysis

To what extent can an EU regulation on deforestation-free products contribute to reducing deforestation in global supply chains?

The following SWOT analysis explores the **S**trengths, **W**eaknesses, **O**pportunities and **T**hreats on halting and reversing EU-driven global deforestation of the EU COM's proposal from 17 November 2021. (European Commission 2021a)

## **Strengths**



- Comprehensive, effective and continuous due diligence, including a risk assessment for
  commodities with non-negligible risk would become mandatory for all operators. Importing would be allowed only if companies can prove that they meet the specified due diligence criteria. Clear traceability information would have to be provided. Selected forest-risk
  commodities (FRCs) produced on recently deforested land would no longer have access to
  the EU market.
- All operators who place FRCs and their processed products on the EU market or export them are subject to the regulation.
- Market operators would have to provide subsequent traders with information about their supply chains of FRCs and their due diligence investigations. Market participants that are not small or medium enterprises (SMEs) would have to publish an annual report on their due diligence system.
- An EU-wide database for the registration of market participants and traders and their due diligence declarations would lead to greater transparency and traceability in supply chains.
- The regulation provides for fines and clear enforcement measures. EU member states would be obliged to define and implement sanctions for infringements of the regulation.
- The EU Commission (EU COM) would engage with producer countries affected by the regulation to develop partnerships and cooperation with the full participation of all stakeholders, including civil society, Indigenous peoples, local communities, and the private sector including SMEs and small farmers.



## Specific strengths regarding soy and beef supply chains from Mercosur

- A strict market regulation for FRCs is especially important for ecosystems that have already
  lost large areas of their original surface and which are already at the edge of irreversible
  tipping points at which they can no longer cope with environmental change, such as the
  Brazilian biomes Amazon, Caatinga and Cerrado. (Lovejoy and Nobre, 2018)
- Transparency in supply chains driven by an EU regulation could benefit producer countrie
  to make use of a system to track the origin their products. For example, in Brazil it is currently is not possible to track beef from indirect suppliers.

### Weaknesses



- The current proposal does not consider other natural ecosystems with high ecological or social importance, such as the grasslands, wetlands, shrublands or savannah of the Cerrado. Just like forests, other ecosystems also provide livelihoods for local communities and Indigenous people, harbour endemic species and play an important role in absorbing carbon dioxide.
- The control of EU imports would apply to beef, palm oil, soy, timber, cocoa, coffee and
  their processed products. Other high-risk commodities such as rubber, maize and processed beef are not regulated by the current proposal. Rubber is responsible for a significant amount of deforestation in Southeast Asia. (Global Witness 2019)
- The finance sector would not be targeted by the regulation, although European banks are
  contributing significantly to deforestation through their financing. According to Global Witness (Global Witness 2021), financial institutions based in EU countries and the United Kingdom generated higher revenues from investments in the largest deforestation operations
  than either the United States or China.
- Placing products on the market would not be subject to compliance with international human rights standards. According to the proposal, only national law in the producing countries would be binding. In many forest countries, the human rights of Indigenous communities are not effectively protected. If companies are incentivised to appropriate areas under cultivation by local communities in order to avoid new deforestation, and if there is no strong human rights protection that respects and secures collective land and territorial rights, then such actions could cause harm to people and their livelihoods.
- Companies sourcing from low-risk countries would not need to carry out a risk assessment.
   This could have a leakage effect if trade flows shift to low-risk countries that have weaker regulatory frameworks and which sell products from high-risk countries under false declarations to the EU market.
- Defining 'deforestation-free' as goods produced on land that has not been subject to deforestation or forest degradation only after 31 December 2020 allows soy production for the EU to expand to former pasture areas, because cattle grazing is typically the first activity on land once forests are cleared. Cattle farming for non-EU markets could then be displaced to forest areas leading to new deforestation activity.
- The proposal does not yet include a sufficient framework to guarantee effective prosecution, including accessible ways to provide proof for violations. In the proposal, the amount of the fines is limited to a maximum of 4% of the annual turnover of the economic operators and could be a relatively low deterrent.



## Specific weaknesses regarding soy and beef supply chains from Mercosur

- The displacement effect described above (i.e. pasture areas that existed before December 2020 being used for soy production for the EU market, while grazing livestock whose production is not destined for the EU market moves into forest areas) could be very significant in Latin America.
- The proposal does not foresee any measures to take care of the preservation of ecosystems of high environmental value. Large natural areas such as those of the Gran Chaco and Cerrado need measures to preserve ecosystems from degradation. The proposal does not include incentive mechanisms for farmers to produce sustainably in forest countries. Sustainable production is usually more cost-intensive, and in order to be able to take small producers along with them, financial incentives must be offered to switch production to sustainable and deforestation-free.

## **Opportunities**



- In the Glasgow Leaders' Declaration on Forest and Land Use (UN Climate Change Conference UK 2021a), 141 countries made commitments to halt deforestation by 2030. Mercosur countries with their significant share of forests, other important ecosystems and demand markets for FRCs such as China and EU member states signed the commitment. This is a great opportunity to prioritise deforestation in global supply chains and to counter leakage effects of the proposal, such as commodities produced on deforested areas being sold to other markets.
- The proposal would enable the creation of a playing field for industry and businesses by providing uniform regulations for all operators putting FRCs and their products on the EU market or exporting them from the EU.



## Specific opportunities regarding soy and beef supply chains from Mercosur

- Cerrado's soy sector could grow without additional conversion of natural vegetation. (Fishbein et al. 2019) In Argentina, Brazil and Paraguay, a huge amount of land classified as pasture is unproductive to secure the ownership of the land. The recovery of 12 million hectares of degraded pastures could generate additional production of 17.7 million bovines while reducing the need for new agricultural land. (Feltran-Barbieri and Féres 2021) It might be a business model for investment in the regeneration of degraded land and the purchase of products from the land.
- Beef directed to the EU market is already tracked for sanitary reasons. Therefore, in Brazil a
  registration and monitoring process for direct supply chains is already established. A demand from the EU to also monitor indirect supply chains to avoid deforestation would
  build up the system to use it.
- In autumn 2022, elections will be held in Brazil, which could lead to a change in government. A new government could step up its efforts to support the implementation of zero-deforestation monitoring and control commitments.
- Argentina has ambitious preservation and sustainable use laws, such as the Ley de Bosques
   (national 'forest law') that preserves 80% of current forest cover in the country. The obligation through the regulation for companies importing into the EU to comply with the national legislation of producing countries could strengthen the governance structures of those countries.
- In the coalition agreement, the new German government commits to legally binding regulations that prevent the import of products and raw materials associated with deforestation. It also supports the EU COM's proposal for EU Regulation on deforestation-free products.
   (SPD. Bündnis90/Die Grünen, EDP 2021)
- The EU is a Party to the United Nations Convention on Biological Diversity (CBD) and has
  made several international commitments to halt biodiversity loss worldwide (among others
  the SDGs 14 and 15, the Convention on International Trade in Endangered Species of Wild
  Fauna and Flora (CITES), the Convention on Migratory Species (CMS). (European Commission n.d.) Ending deforestation in EU supply chains could contribute significantly to the protection of biodiversity, as deforestation is a major cause of biodiversity loss. (European
  Commission 2020)

### **Threats**



- Restricting the requirements to certain commodities may lead to a shift in demand towards less efficient commodities that consume more land, which could lead to further deforestation. (Khalid 2020)
- FRCs could be imported via countries with weaker regulations. From there, they could be imported into the EU, thus circumventing EU regulation. Trade diversion would then not lead to a change in the production patterns of FRCs, but merely to a shift in export destinations.
- The implementation of the EU Timber Regulation (EUTR) showed that a lack of consciousness for the regulation at customs and inadequate resources cause difficulties in controlling imports. There is a risk of the legislative EU COM proposal being watered down by the European Council (EC) and thus losing effectiveness. For example, the certification mechanism could be more integrated and thus partially replace due diligence. There is also a risk that commodities such as soy cake will be removed from the regulation annexes, which would leave unaddressed an important driver of ecosystem destruction.



## Specific threats regarding soy and beef supply chains from Mercosur

Difficulties might occur in implementing deforestation-free supply chains, as forest and human rights protection governance in Brazil in particular, but also in Argentina, is still weak.
 (Ocaña 2020) Currently even illegal deforestation and land grabbing is rarely punished or avoided. (Variety of authors 2021) Ecosystems such as the Gran Chaco are already 25% converted for agricultural use. (The Nature Conservancy n.d.) Similar developments can be observed in other ecosystems, such as the Pantanal, whose native vegetation could be extinguished by 2050 at current rates of development. (WWF n.d.)

#### 3.2.1 Recommendations

The EU COM's proposal for an EU Regulation on deforestation-free commodities opens up opportunities to limit deforestation in Mercosur by limiting the placing of deforestation-linked commodities on the EU market. Serious weaknesses and loopholes could, however, significantly reduce the effectiveness of the regulation. Therefore, several improvements and specifications are necessary.

It is important that the regulation also covers, from the start, the protection of ecosystems with high environmental value beyond narrowly defined 'forests', and that it applies to all commodities that are highly associated with deforestation, degradation of natural forests and conversion and degradation of other natural ecosystems, including rubber, poultry and maize. (WWF 2021b)

Additionally, the legislation should contain clear provisions to protect the rights of Indigenous peoples and local communities and be based on international standards of human rights such as the United Nations Guiding Principles on Business and Human Rights and OECD Guidelines for Multinational Enterprises. It should respect customary property rights and guarantee free, prior and informed consent (FPIC). (WWF 2021b) Comprehensive due diligence including risk assessment and if necessary risk mitigation should be independent of the countries from which companies source their commodities and apply to companies of all sizes. If all companies were made legally responsible for complying with the due diligence and risk assessment obligations, regardless of whether a product comes from a country of origin generally classified as low or high risk, this would ensure a level playing field. (WWF 2021b) This would not create an unnecessary burden, as the risk assessment for commodities where the risk is indeed low should be easy and straightforward.

Country benchmarking, after countries undergo a three-stage risk assessment, should include additional aspects in order to be effective. These should include, for example, land ownership rights, corruption and the implementation of existing agreements between the EU and the producer country. Furthermore, there should be no 'simplified due diligence' for market participants and no 'low risk category' in the benchmarking, as this might weaken the effectiveness of the legislation. **Due diligence should apply to risk raw materials from all countries of origin.** 

Implementation of the EU Timber Regulation (EUTR) has shown that compliance can only be expected if penalties are proportionate and dissuasive. The EU regulation on deforestation-free products must include **effective prosecution** and must **specify the fines to provide deterrence**. Effective implementation also requires **public transparency in product information** and enforcement **controls in all EU member states**. **Certification should not be used to exempt** companies from their legal due diligence obligations. However, it could be used as part of a company's risk assessment and mitigation.

Third parties should be given a legal claim in the case of impairment due to deforestation or forest degradation. **Civil liability and access to justice** is important in order to create the possibility of compensation in case of damage.

The reporting requirements are not sufficient as they exclude small and medium-sized enterprises and there is the possibility of reporting under other legislation. Due diligence reporting is an important tool for monitoring compliance with the regulation. Therefore, all companies should report in accordance with the new legislation.

The Regulation on deforestation-free products should further lay down rules imposing **due diligence obligations on financial institutions** that operate in the EU. These rules should ensure that the financial and banking sector in the EU is not directly causing or contributing to deforestation, forest degradation, conversion or degradation of natural ecosystems and human rights abuses. (Greepeace European Union 2020)

Implementation of the EU Taxonomy Regulation and the future Corporate Sustainability Reporting Directive (see chapter 6 on Sustainable finance) could complement and support this legislative initiative on deforestation.

With its regulation, the EU must also signal its willingness to contribute to the design and implementation of **incentive mechanisms for partner countries** that are going to be necessary to help fund the transition to deforestation-free supply chains. Incentive mechanisms include political dialogue and technical cooperation to enhance sustainable forest governance in producer countries.

## 3.2.2 Stakeholders with influence on the approach

**European Commission** (EU COM): The EU COM's Directorate-General for Environment (DG ENV) was the lead DG for the impact assessment and the proposal on 'Minimising the risk of deforestation and forest degradation associated with commodities placed on the EU market'. During the impact assessment process representatives of several other Directorate Generals (among others DG TRADE, JUST, GROW, AGRI, etc.) met five times within an inter-service group to provide input for the evaluation. (European Commission 2021c)

**European Parliament** (EP): The EP is organising hearings and meetings with stakeholders and discussing the proposal within the Committee on Environment, Public Health and Food Safety (ENVI). In 2020, Delara Burkhardt (S&D, Germany) was appointed ENVI committee rapporteur on this legislation. Since November 2021, she has accompanied the legislative proposal as shadow rapporteur. Now, Christophe Hansen (EPP, Luxemburg) is new ENVI committee rapporteur on the legislation.

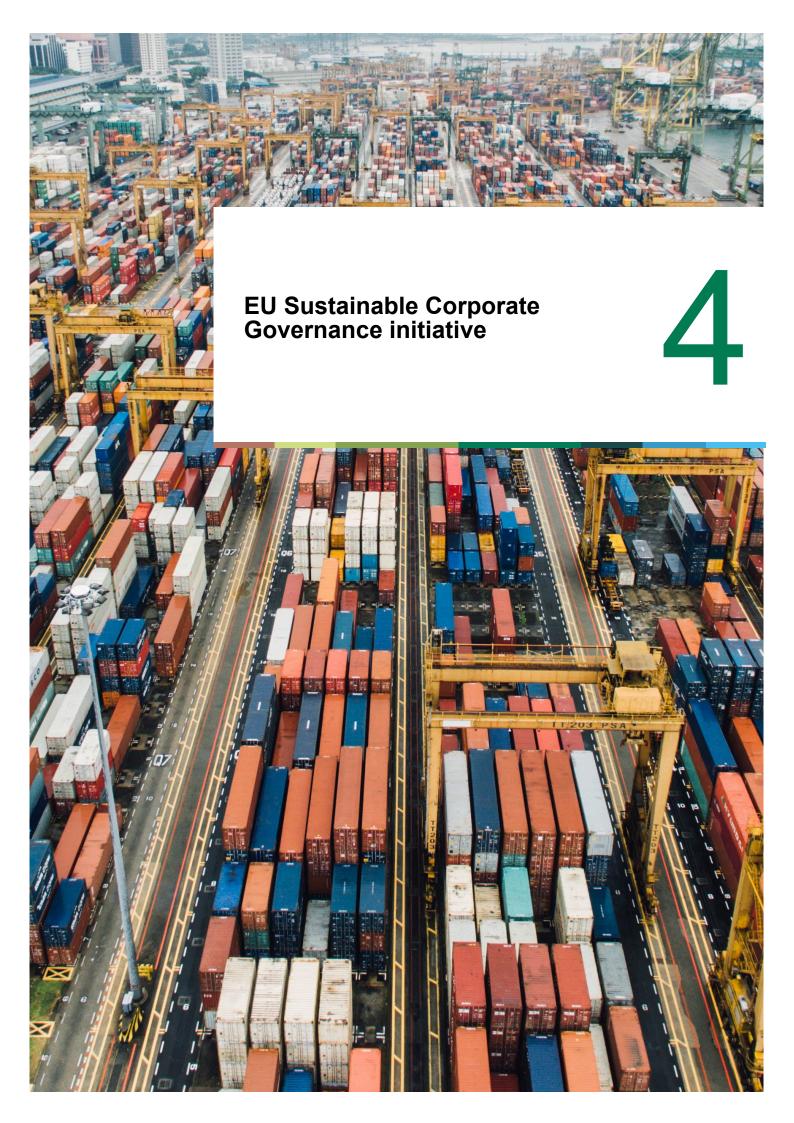
Council of the European Union: The Agriculture and Fisheries (AgriFish) Council and the Environment (Envi) Council are responsible for discussing the legislative proposal within the Council of the EU, which is comprised of representatives of all 27 member states. As with all legislative proposals, Council and EP will have to find a consensus and ultimately adopt the regulation. The French government has stated that ending imported deforestation will be a priority issue during the French Council presidency in the first half of 2022. (Ministère de l'Europe et des Affaires Étrangères 2021) France will set up an ad hoc working group with members of the AgriFish and Envi Council.

Non-governmental organisations: More than 180 NGOs, (Together4Forests 2022) mostly from Europe but also from producer countries, including Client Earth, Greenpeace, DUH, Conservation International Europe, Environmental Investigation Agency, Fern, WWF and Global Witness support the campaign #together4forests. More than 1 million people took part in the campaign in November 2020, calling for a strong new EU law to protect the world's forests and other ecosystems through a public consultation. The public consultation was the second most popular in the EU's history. This shows the strong public support behind the initiative.

#### 3.2.3 Current status and timeline

The legislative proposal published by the EU COM on 17 November 2021 currently must go through the ordinary legislative procedure and must be formally adopted by both the EP and the Council of the European Union. Both bodies may propose amendments. The agreement on the text can take up to two years. (Liboreiro 2022)

If adopted, the regulation will provide for a transitional period during which traders and operators would have 12 months to put in place appropriate due diligence systems and to submit due diligence declarations before placing the commodities concerned on, or exporting them from, the EU market. This transition period would be extended to 24 months for micro-enterprises. (European Commission 2021a)



# 4.1 What is the EU Sustainable Corporate Governance initiative?

Burning factories, dam breaks at mining sides, deforested land and child labour on plantations: catastrophic conditions in the value chains of companies are widespread, especially at the beginning of global value chains. The COVID-19 pandemic has further exposed and highlighted the fragilities and inequities in these global chains. The European Commission (EU COM) is working on a Sustainable Corporate Governance initiative that intends to address these problems by introducing mandatory human rights and environmental due diligence standards for companies. (Business & Human Rights Ressource Center 2020)

Due diligence is a continuous, risk-based process through which companies must effectively identify, prevent and mitigate actual and potential adverse impacts in their operations and along their value chains and business relationships. They must also track the effectiveness of their response and account for how they address the identified adverse impacts (see Figure 1). (United Nations 2011)

**Identify & assess** Communicate adverse impacts in operations, supply chains how impacts are addressed & business relationships **Embed** Provide for or responsible business conduct cooperate into policies & in remediation management systems when appropriate Cease, prevent or mitigate Track implementation adverse impacts and results

Figure 1: Six steps of the due diligence process

Source: Germanwatch, based on OECD (2018), OECD Due Diligence Guidance for Responsible Business Conduct.

In February 2020, the results of a study arranged by the EU COM affirmed that voluntary measures have so far proved to be vastly insufficient and that there is an urgent need for regulatory action at EU level. (British Institute of International and Comparative Law 2020) Meanwhile EU member states France, the Netherlands (on child labour), and most recently Germany have adopted legislation on mandatory due diligence; other member states are also considering the adoption of such legislation, including Austria, Belgium, Finland and Luxembourg.

In April 2020, the EU Commissioner for Justice, Didier Reynders, committed to a legislative initiative in this regard. About a year later, in March 2021, the European Parliament (EP) followed up with a legislative initiative procedure (INL) setting out its expectations for legislation to be developed by the

EU COM. (European Parliament 2021a) After several delays, the respective EU COM proposal is now expected to be presented on 23 February 2022.

The EU already regulates product-specific due diligence requirements through the Conflict Minerals Regulation, the Timber Regulation and the Anti-Torture Regulation, amongst others. The recently proposed Regulation on deforestation-free products will also set product-specific requirements. The upcoming Sustainable Corporate Governance legislation is set to define due diligence obligations across sectors building on the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises.

## 4.2 SWOT analysis

To what extent can the EU Sustainable Corporate Governance initiative contribute to reducing deforestation in global supply chains?

The Sustainable Corporate Governance initiative is aimed at addressing, inter alia, business's adverse impacts on human rights *and* the environment in global supply chains. It is not designed to specifically deal with product-related deforestation. However, deforestation is one of the major risks that companies, such as agricultural businesses, are facing in their supply chains and therefore would have to address and mitigate as required under the initiative. In fact, the EP, in its legislative report, states that environmental impacts "should include, but should not be limited to, production of waste, diffuse pollution and greenhouse emissions that lead to a global warming of more than 1.5°C above pre-industrial levels, deforestation, and any other impact on the climate, air, soil and water quality, the sustainable use of natural resources, biodiversity and ecosystems". (European Parliament 2021a, 20)

The contribution of the future EU Sustainable Corporate Governance legislation to reducing deforestation highly depends on the applied definition of environmental due diligence. As the EU COM's proposal has not yet been published, the SWOT analysis in this chapter is primarily based on the recommendations of the EP's legislative report. The upcoming EU COM proposal will have to be negotiated between the EP, the EU COM and the Council, i.e. the member states. Political compromises will have to be found. These will inevitably affect the strengths and weaknesses described below.

## **Strengths**



- According to the EP's suggestions, the upcoming legislation should be broad in scope and
  possibly cover all large EU undertakings, including the financial sector. The EP is also proposing that it covers "publicly listed small and medium-sized undertakings and high-risk
  small and medium-sized undertakings" (European Parliament 2021a, no 9) and non-EU
  companies that are active on the internal market. This would allow for a comprehensive
  horizontal approach in the legislation.
- With regard to the scope of the due diligence obligation, the legislation should cover the entire value chain. (European Parliament 2021a, no 7) The horizontal scope of the obligation should be an important strength of the upcoming instrument and contribute to its effectiveness as it counteracts a shift of problems and loopholes that would be connected to placing obligations on a number of defined products only.
- Concerning the definition of environmental impacts, the EP is suggesting that the legislation should cover the "production of waste, diffuse pollution and greenhouse emissions that lead to a global warming of more than 1.5°C above pre-industrial levels, deforestation, and any

other impact on the climate, air, soil and water quality, the sustainable use of natural resources, biodiversity and ecosystems". (European Parliament 2021a, no 23 Annex to the resolution) This definition would require companies to address adverse impacts in their value chains relating to deforestation and the loss of biodiversity. The legislative report generally stresses that the enjoyment of human rights depends on the preservation of biodiversity as the foundation of ecosystem services. (European Parliament 2021a, no 5) A definition that includes deforestation and adverse impacts on biodiversity makes it possible for companies to collectively address these problems against ongoing pressures on prices.

- Due diligence implies that relevant stakeholders, including Indigenous communities, are involved and the legislative report explicitly mentions that such involvement is "conducted in accordance with international human rights standards, such as the United Nations Declaration on the Rights of Indigenous Peoples, including free, prior and informed consent and Indigenous peoples' right to self-determination". (European Parliament 2021a, no 19 and 39)
- With regard to enforcement, the upcoming legislation should, according to the European
  Parliament (EP) and as previously announced by the EU COM, include a civil liability regime
  and an administrative enforcement mechanism via national authorities. A combination of
  both instruments would allow for a strong enforcement of the obligations.
- The Sustainable Corporate Governance initiative could bring about positive changes on the
  ground. Production workers benefit from improved working conditions when companies
  are obliged to comply with social and environmental standards. Workers in a factory are
  better off in terms of their health if the factory complies with mandatory emissions standards and, for example, is required to install an exhaust filter.



## **Specific strengths regarding soy and beef supply chains from Mercosur**

 Concerning the scope of the upcoming legislation, the due diligence obligations apply to major German and EU feed producers if companies with more than 500 employees are covered.

#### Weaknesses



- The effectiveness of the upcoming sustainable corporate governance legislation in addressing environmental damages depends to a large extent on the definition thereof. If references to deforestation and biodiversity are missing in the definition of environmental due diligence in the final proposal, there is a risk that many companies will not act upon it and will fail to address these risks in their supply chain.
- With regard to potential weakness in the **enforcement of the legislation**, Parliament "underlines that such authorities should be provided with sufficient resources and powers to realize their mission; considers that the EU COM should set up a European due diligence network to be responsible for, together with the national competent authorities, the coordination and convergence of regulatory, investigative, enforcement and supervisory practices, and the sharing of information and to monitor the performance of national competent authorities". (European Parliament 2021a, no 23) A law without sanctions is a mere paper tiger and remains ineffective.
- Companies can prioritise risks and the actual and potential adverse impacts they address in
  their supply chains according to the severity and likelihood of adverse impact. However,
  prioritisation is only relevant where it is not possible to address all potential and actual adverse impacts immediately and should be based on a comprehensive risk assessment undertaken at the outset.

 A company's due diligence obligation should not be simply passed on to producers in the supply chain, without the mother company fulfilling its own due diligence obligation properly.



Specific weaknesses regarding soy and beef supply chains from Mercosur

None.

## **Opportunities**



- The COVID-19 pandemic has exposed the fragilities and inequities in global value chains, and as a result some companies are becoming more aware of the importance of reliable and sustainable relationships with their suppliers.
- Further pressure for companies to act and improve corporate accountability in global value chains arises through stricter criteria that financial institutions are applying (compare chapter 6 in this paper).
- There are developments in several countries addressing human rights and environmental due diligence in legislation, such as in the 2017 French Law on the Duty of Vigilance, the German Supply Chain Act adopted in June 2021 and the Norwegian Due Diligence Law from 2021. In the Netherlands, Finland, Luxembourg, Belgium and Austria there are parliamentary processes ongoing or awaiting action from the EU COM. These legislative developments increase the pressure on the EU COM to act. Moreover, there is the so-called treaty process at the United Nations negotiating an international approach to due diligence.



## **Specific opportunities regarding soy and beef supply chains from Mercosur**

 In November 2021 the EU COM put forward a proposal on deforestation-free product supply chains and there has been much debate and voluntary pledges around this issue lately.
 A future sustainable corporate governance proposal could complement these EU legislative efforts and set the benchmark for human rights and environmental due diligence across different sectors.

### **Threats**



- Despite the poor results voluntary approaches have shown (see chapter 7), major business
  associations are continuing to strongly lobby against mandatory obligations and sound enforcement, including liability. They have political allies in the EU COM and among member
  states and could therefore try to water down an effective proposal on sustainable corporate governance.
- The price pressure in international competition on certain products continues to pose a challenge for business when changing their pricing policies in global value chains.



Specific threats regarding soy and beef supply chains from Mercosur

None.

### 4.2.1 Recommendations

The upcoming Sustainable Corporate Governance proposal should be seen as part of a package to provide the framework for responsible corporate behaviour in global value chains and for addressing environmental damages, such as deforestation. It could set a benchmark for human rights and environmental due diligence that would affect not only the European market but all businesses directly or indirectly involved in this market, as well as their business relationships. In order to provide an effective framework for business activities, it should address the following four points.

First, environmental due diligence must be well defined. Since, unlike in the human rights field, there is not a comprehensive body of internationally recognised environmental standards covering all environmental impacts, the EU COM must provide a definition of adverse impacts that must be addressed by environmental due diligence, These should include, as a minimum, the types of impacts the EP is suggesting (see above) as well as obligations on companies to account for their climate change impacts by covering all three scopes of emissions defined by the Greenhouse Gas Protocol. (World Business Council on Sustainable Development 2004)

Second, the due diligence obligation should cover the entire value chain. Across sectors, the risks for adverse human rights and environmental impacts are not to be found with first-tier suppliers only. For legislation to be effective, it needs to require companies to address these risks wherever they occur in global value chains, which may frequently be at the very beginning of these chains, as is the case with deforestation.

Third, the upcoming legislation must strengthen the rights of people affected and enable them to claim compensation before European courts if a company has not fulfilled its due diligence obligations. In this context, the EP stresses the need for access to effective legal remedies. Such effective remedies imply that the "burden of proof would be shifted from a victim to an undertaking to prove that an undertaking did not have control over a business entity involved in the human rights abuse" and that the limitation period for bringing civil liability claims is reasonable. (European Parliament 2021a, no. 26, no. 53 Annex to the Resolution)

Fourth, the scope of the upcoming legislation should include small and medium-sized enterprises (SMEs) if their main field of activity is in a risk sector, such as the food industry. According to the United Nations Guiding Principles on Business and Human Rights, all companies should assume responsibility for human rights in their supply chains. Some SMEs are already systematically addressing human rights, for instance in industry initiatives such as the Fair Wear Foundation. It is important to include high-risk SMEs, because the severity of the adverse impact on human rights and the environment does not depend on the size of company, but rather on its business activities.

## 4.2.2 Stakeholders with influence on the approach

**European Commission (EU COM)**: Responsibility for the Sustainable Corporate Governance initiative lies with the Commissioner for Justice, Didier Reynders, and the Commissioner for the Internal Market, Thierry Breton. Commission Vice-President for Values and Transparency, Věra Jourová, is overseeing the work. Initially, the Commissioner for Justice was leading the development of the file and had positioned himself towards ambitious legislation that would address many of the aspects mentioned above.

In late spring 2021 Thierry Breton was appointed as co-lead on the file. Among the commissioners, the design of the proposal has been the subject of controversy in recent months. It remains to be seen what the upcoming legislation, for which the first proposal has been delayed until at least February 2022, will look like.

**European Parliament (EP):** The EP's position has been described in more detail above. The main part of the work carried out so far has been taking place within the Committee on Legal Affairs. Crucial to discussions on the file will be whether or not consensus on effective legislation can be reached across party boundaries, as was largely the case with the legislative report in spring 2021.

**EU member states**: It is unclear as of yet what the majority position will be in the Council. Some member states have national legislation in place that they want to uphold, like the French government, or that they are holding back as they wait for the EU proposal, such as the Dutch, Finnish or Austrian governments. The Dutch government has presented ambitious building blocks for future EU legislation in November and is pushing the EU COM in that regard. (Government of the Netherlands 2021) The new German government has committed to effective EU legislation based on the UN Guiding Principles and indirectly recognised that the European proposal must go further than, and thus possibly improve, German law. (SPD, Bündnis 90/ Die Grünen, FDP 2021) Eastern European countries are not yet committed and remain observant in relation to the initiative.

**Business associations**: Some business associations had been arguing against the development of a national supply chain act in Germany or the Netherlands, claiming that it would take pan-European legislation to address the problem and create a level playing field. Now that there is an EU process ongoing, they are attempting to influence the upcoming EU legislation in their favour, especially with regard to the scope and enforcement mechanisms of the future directive.

Trade unions and civil society organisations: Trade unions and NGOs working on human rights and the environment have been actively pushing the EU COM to address the adverse human rights and environmental impacts in global value chains. They have succeeded in having it put on the agenda of the current Commission and are trying to keep up the pressure on developing an effective legal framework that would strengthen the rights of people affected and also hold companies accountable and liable for damages in their value chains.

### 4.2.3 Current status and timeline

The EU COM is expected to present its Sustainable Corporate Governance proposal on 23 February 2022. Afterwards, the proposal will be discussed by the Council of the EU under the French, Czech and Swedish presidencies in 2022 and 2023. It will be debated within the EP, and reports and amendments will be drafted starting from summer 2022 onwards. Depending on how the negotiations between EP, Council and EU COM develop, the legislation could be finalised in 2024. The Commissioner of Justice, Didier Reynders, has previously stated that he would like to see the legislation being adopted before the European elections in spring 2024. In the most probable case that the Sustainable Corporate Governance initiative becomes a directive, member states would be obliged to create or adapt their national legislation to meet the aims of the directive within a defined timeframe. Member states might have until 2026 to transfer the directive into national legislation, with a possible additional transition period until, for example, 2027.



## 5.1 What is a reform of EU trade agreements?

Recent scientific publications confirm that free trade agreements are an important factor for agricultural land expansion and deforestation. (Raza 2020)

The European Commission (EU COM) regularly reviews EU trade policy and practices to address current challenges, for example the COVID-19 pandemic or the climate crisis. The new EU COM headed by Ursula von der Leyen published its new trade strategy entitled *An Open, Sustainable and Assertive Trade Policy* (European Commission 2021b) in February 2021.

Since 2011, the European Union's free trade agreements (FTAs) include Trade and Sustainable Development (TSD) chapters that address specific environmental aspects and labour rights. This includes climate targets and conventions of the International Labour Organization (ILO). The EU Vietnam FTA for example contains specific provisions on the promotion of sustainable forestry. (Raza 2020) Until now, however, EU FTAs exempted commitments made in TSD chapters from binding dispute settlement mechanisms, making them difficult to enforce. Disputes regarding commitments made in the TSD were at most addressed by expert panels tasked with issuing a report and making recommendations for dispute resolutions.

The EU COM's new trade strategy promises to support the green transition towards more sustainable trade aligned with the objectives of the European Green Deal (EGD). The overarching objective of the EGD is the transition towards a climate neutral, resource efficient and resilient economy and fair society by 2050. (European Commission 2021b) The EU's roadmap to achieve the EGD foresees the adoption of measures to halt deforestation in supply chains. These include forthcoming legislation on deforestation-free commodities (see chapter 3) and sustainable corporate governance (see chapter 4) and it advocates considering the respect of the Paris Climate Agreement as an essential element in future trade agreements. (European Commission 2019c)

#### The EU Mercosur agreement

After 20 years of negotiation, the EU and Mercosur concluded negotiations for a bilateral FTA on 28 June 2019. Import tariffs and export taxes are to be gradually eliminated or significantly reduced. The EU Mercosur FTA is part of a larger Association Agreement (AA), which, as well as trade, is about cooperation and political dialogue between the two blocks. (European Commission 2019d)

The EU Mercosur FTA contains a TSD chapter which commits the parties to "promote, as appropriate and with their prior informed consent, the inclusion of forest-based local communities and Indigenous peoples in sustainable supply chains of timber and non-timber forest products" and to "implement measures to combat illegal logging and related trade". It also commits parties to "exchange information on trade-related initiatives on sustainable forest management, forest governance and on the conservation of forest cover". (European Commission 2019e)

While an 'agreement in principle' has been reached, some details related to the FTA are still being negotiated. In particular, the EU is attempting to secure additional commitments related to climate and environmental protection, without reopening the main text. While it would be politically challenging to renegotiate the text of the agreement itself, it is legally possible up until its final ratification by the European Parliament (EP), Council of the European Union, parliaments of the EU member

states (if the FTA remains part of a broader Association Agreement) and Mercosur countries. (Montevideo Portal 2021)

## 5.2 SWOT analysis

To what extent can a reform of EU trade agreements contribute to reducing deforestation in global supply chains?

In the following, we identify **S**trengths, **W**eaknesses, **O**pportunities and **T**hreats (SWOT) of the EU's current trade policy in establishing deforestation-free supply chains. Specifically, the EU Mercosur Agreement and its possible effectiveness to reduce demand-driven deforestation in EU agricultural supply chains are subject of the SWOT analysis.

## **Strengths**



- Trade agreements could define mandatory sustainability criteria for forest-risk commodities (FRCs) traded between the partners, for example human rights and ecosystem protection measures. Mandatory sustainability criteria include, for example, transparency and traceability in supply chains.
- FRCs from **sustainable production** could be **promoted** by giving them better market access through **lower tariffs**.
- The EU proposes to include "the respect of the Paris Agreement" as an essential element in
  future trade agreements and a commitment to "prioritise effective implementation of the
  Convention on Biological Diversity in trade and investment agreements". (European Commission 2021) An 'essential elements clause' on deforestation-free supply could provide the
  legal basis for restrictive trade measures where there are serious violations of the clause.
  (Müller 2020)
- Trade agreements could incorporate a country's commitment as submitted in its Nationally
   Determined Contributions (NDCs) to shift from carbon-intensive industries and supply
   chains that cause deforestation to green industries free of degradation to ecosystems or
   forests.
- Recent EU trade agreements contain a greater number and level of comprehensiveness of provisions relating to sustainable forestry or trade in forest products. (Raza et al. 2020)



## Specific strengths regarding soy and beef supply chains from Mercosur

- The EU-Mercosur Association Agreement considers the protection of human rights as an
  essential element. If a party violates an essential element, the other party has the right to
  take immediate appropriate measures, which may lead to a partial or full abandonment of
  the agreement. (Greenpeace Netherlands n.d.)
- The Trade and Sustainable Development (TSD) chapter of the EU Mercosur Agreement
  - promotes due diligence within supply chains, including support of public and private initiatives to halt deforestation; (European Commission 2019e)
  - commits each Party to effectively implement the United Nations Framework Convention on Climate Change (UNFCCC) and the Paris Climate Agreement; (European Commission 2019 Art. 6(2)(a))
  - obliges both trade parties to implement measures to combat illegal logging and related trade. (European Commission 2019 Art. 8(2)(c))

### Weaknesses



- Although recent EU trade agreements contain more provisions with greater detail relating
  to sustainable forestry or trade in forest products, these are so far only "essentially of a best
  endeavours nature". (Raza et al. 2020) In cases of non-compliance with sustainable development provisions, only cooperation and settlement through dialogue are foreseen. (Müller 2020) Trade measures are not an option, as the normal state-to-state dispute settlement mechanism is not applicable for these provisions.
- Land conversion in South America to meet the global demand for beef and soy will continue to rise. (Climate Focus 2020) Trade agreements with deforestation-free supply chain commitments would only address trading partners. Other demand markets are not addressed by trade policy alignment.



## Specific weaknesses regarding soy and beef supply chains from Mercosur

- Increased trade with FRCs frequently leads to an expansion of agricultural areas and
  thereby often to deforestation. The Agreement would reduce or eliminate export tariffs on
  soybean products from Mercosur, which reduces costs and therefore increases demand for
  soy as animal feed and biofuels in the EU. The amount of beef from Mercosur that can enter the EU market tariff-free is expanded by 99,000 tons per year. (Czaplicki Cabezas et al.
  2019) Hence, liberalisation commitments risk an increase of between 122,000 and 260,000
  hectares in Mercosur countries, especially in areas adjacent to Indigenous lands. (Aguiar et
  al. 2020)
- The TSD chapter is excluded from the Free Trade Agreement's dispute settlement mechanism. Any disputes with regard to its provisions will only be discussed by a panel of experts issuing a report with recommendations. Trade sanctions in the event of a breach of commitments by a party mechanism are not possible. (European Commission 2019e)
- Environmental and climate protection are not defined as essential elements of the Free
  Trade Agreement. Hence, there is no legal basis for appropriate measures abandoning the
  treaty in case of non-compliance with the Paris Climate Agreement or with commitments
- TSD provisions for applying the right to free, prior and informed consent (FPIC) before
  adopting a measure that might affect Indigenous and local communities or other respective international agreements on the rights of Indigenous people are not obligatory.
- The commitment to take measures against illegal logging and deforestation in the TSD
  chapter does not define the type of measures to be taken or which legal standards are
  used to determine whether deforestation is illegal. Therefore, it would be difficult to clearly
  identify a violation of this commitment.

## **Opportunities**



- EU requirements for imports have the potential to influence standards in other markets. If the EU imports only products that provide information on their origin and deforestation-free supply chains, other consumer markets could have better access to this information. This would make it easier to adopt similar policies against deforestation in other supply chains.
- Trade agreements that restrict EU imports to deforestation-free products could generally put pressure on producer governments to include measures against deforestation on the political agenda and to improve the transparency of supply chains. (Pereira 2021)
- Leading economies, including the EU and China, as well as Mercosur countries made a commitment to end deforestation by 2030 during COP 26. This could strengthen the legitimacy of binding anti-deforestation provisions in trade agreements.



## Specific opportunities regarding soy and beef supply chains from Mercosur

- The EU-Mercosur Agreement has not yet been ratified, and renegotiations to include binding measures against deforestation are still possible. Recent political developments have improved the chances of incorporating more effective anti-deforestation provisions.
- Brazilian Congress, civil society and some in the business sector, the latter pressured by in ternational trade partners, have expressed resistance to the weakening of environmental and social rights under the government of Jair Bolsonaro. (Müller 2020) In the upcoming elections in Brazil (October 2022) former president Luiz Inácio Lula da Silva is leading in polls. Da Silva is in favour of renegotiating the EU-Mercosur Agreement (France 24 2021) and has a good record on reducing deforestation during his previous terms in office.
- Uruguay makes a commitment in its NDC to maintain 100% of native forest area by 2025
  and seeks to reverse degradation processes and preserve at least 50% of the peatland
  area. In its NDC, Paraguay states its aim to strengthen resilient ecosystems, use naturebased solutions, and expand nature protection areas and sustainable agricultural protection. These measures could contribute to deforestation-free supply chains from those two
  countries. (DNCC/MADES 2021)
- Argentina's government is interested in maintaining the export tax on soy products because of its importance to government revenues. Export taxes hinder exports.
- Mercosur countries are interested in protecting industrial sectors such as the automotive industry from European imports through trade barriers. This offers opportunities to make trade concessions to Mercosur in exchange for ensuring deforestation-free supply chains.
- In its coalition agreement, the new German government has included a political declaration
  of intent that it will not ratify the EU-Mercosur Agreement until Mercosur countries commit
  to legally binding commitments on environmental, social and human rights protections
  that can be implemented and verified, and also only after concluding a practically enforceable supplementary agreement on the protection and conservation of existing forest areas.
  (SPD, BÜNDNIS 90/DIE GRÜNEN, FDP 2021)

### **Threats**



- If trade restrictions are imposed only on goods originated from illegal logging under national law, producing countries could expand the definition of legal logging and consider legal deforestation of areas deemed environmentally or socially problematic. Deforestation could thus increase. If trade restrictions target only net deforestation, native forest could be cleared by offsetting forest loss elsewhere through reforestation.
- Experience from other EU bilateral agreements shows that so far the EU has not used the clause to suspend trade preferences after a violation of an essential element in the area of human and labour rights under any of its trade agreements. (Zamfir 2019)
- Political conflicts, corruption and financing shortages hamper the implementation of environmental and human rights protection measures in producer countries. Sustainable forest governance requires continuous efforts in capacity building, communication and investments (public and private).



## Specific threats regarding soy and beef supply chains from Mercosur

 Reducing EU imports of problematic commodities linked with deforestation could lead to a redirection of trade of those same commodities to regions with far lower environmental standards.

- The NDCs of Brazil, Paraguay and Argentina contain only weak commitments to halt deforestation. Brazil's commitment to strengthening policies and measures to achieve zero illegal deforestation by 2030 in the Brazilian Amazonia in its updated NDC has been removed and does not include any forest conservation targets or measures. (UNFCCC 2016) Argentina's NDC submitted in 2021, recognises that the reduction in emissions from the forestry and other land use sectors is attributable to a drastic reduction in deforestation. It does not contain any concrete goals or measures against deforestation. (Argentina Presidencia 2021) Paraguay's commitment to effective control of deforestation was deleted in its latest NDC. (DNCC/MADES 2021)
- If the trading parties negotiate commitments on deforestation, compliance with the Paris
  Agreement and labour standards, protection of protected areas and Indigenous areas as
  part of a legally binding additional agreement, the substance of the initial agreement remains unchanged. This would carry the risk of contradictions and incoherence between
  both of the agreements, and a binding state-state dispute settlement for FPIC commitments would be impossible. (Hoffmann and Kraiewski 2021)
- If environmental standards must be met according to national law, there are considerable
  doubts as to whether the current Brazilian legal system and implementation can prevent
  deforestation to an adequate extent. The current administration in Brazil lacks commitment
  to nature conservation and actively dismantles commercial due diligence and command
  and control mechanisms in the environmental arena by cutting funds from federal environmental protection agencies. (Müller 2021)
- The agreement is not congruent with important international agreements and conventions
  on sustainable development, e.g. the Paris Agreement on climate protection. This would
  question the EU's international credibility with regard to its role as international climate
  protection leader.

#### 5.2.1 Recommendations

Until today, the EU's trade policy has not been appropriately aligned with the EGD and does not ensure deforestation-free supply chains. TSD chapters of EU trade agreements provide for environmental and labour commitments, but enforcement mechanisms that ensure compliance on both sides are missing. (Van't Wout 2021)

To ensure deforestation-free supply chains, the EU should adopt regulatory measures to restrict market access to deforestation-free declared FRCs combined with incentive mechanisms to support producers in their transition to sustainable and deforestation-free production. (Khalid 2020) This should include legally binding commitments specifically addressing sustainable production of FRCs, obligations on all operators and investors to adhere to due diligence standards, and commitments by the EU to provide technical and financial assistance for the transition towards sustainable production of FRCs and the implementation of verifiable and effective forest conservation policies. For this, producing and importing parties need to agree on common forest and sustainable production definitions (adapted to each biome) and on cut-off dates after which deforestation is not allowed.

Trading parties should commit to core international agreements on human and labour rights such as the ILO conventions. To ensure that communities affected by the production of FRCs for the European market are heard, new EU trade agreements should contain an obligation for effective implementation of FPIC.

Future trade agreements should include essential element clauses on compliance with the Paris Climate Agreement and on provisions concerning illegal deforestation and the establishment of deforestation-free supply chains. The introduction of a binding state-state dispute settlement with respect to the sustainable development provisions is necessary. As international trade has the potential to add to negative environmental impacts such as deforestation and ecosystem degradation (Balogh 2020), sustainable development commitments of the trading parties must be incorporated into all chapters of a trade agreement, not just in a standalone TSD chapter. (Hoffmann and Krajewski 2021)

Incentive mechanisms for promoting deforestation-free supply chains could involve:

- preferential tariff rates conditional upon improvements in sustainable production;
- technical cooperation to improve forest governance and due diligence in supply chains;
- financial incentives for maintaining and improving forests and other natural ecosystems with major contributions to carbon sequestration and biodiversity. (Raza 2020)

Furthermore, the World Trade Organization (WTO) must be aligned to climate protection instruments such as the Paris Climate Agreement and the Convention on Biological Diversity (CBD). This would avoid legal conflicts between sustainability provisions in regional and bilateral agreements outlined above and would increase policy space for countries to support sustainability objectives. (Müller 2020)

#### Conclusions on the contribution of the negotiated EU Mercosur Agreement to avoid deforestation

Legally, the EU Mercosur FTA is hardly suitable for strengthening forest protection and will rather increase the risk of deforestation by driving FRC trade. The FTA has serious shortcomings regarding environmental and human rights protection associated with deforestation. These shortcomings can only be remedied through renegotiation of the trade part. It must include a binding enforcement of the TSD chapter with clear sustainability obligations, effective implementation measures and an applicable dispute settlement mechanism. The EU Mercosur Agreement should be supplemented by binding due diligence obligations on forest protection, the protection of natural ecosystems and the protection of human rights. The sustainable development commitments of the parties should be incorporated into all chapters of the FTA, e.g. by defining climate targets as essential elements. (Hoffmann and Krajewski 2021)

Implementation of the EU Mercosur FTA could be tied to a legally binding roadmap process with quantifiable criteria and milestones as well as monitoring, cooperation and related incentive measures to reduce the risk of non-compliance. (Hagemejer et al. 2021)

Even if the EU Mercosur FTA is renegotiated and, in the future, contains import restrictions for commodities produced on recently cleared land, further forests might be cleared for other markets. Therefore, the area used for agricultural commodities for the EU should be kept small and the EU should provide financial incentives and technical cooperation to reduce and eventually eliminate deforestation and land conversion. The EU should also enter a dialogue with other major importers of FRCs on joint approaches to addressing deforestation.

Synergies between the FTA and the EU COM's proposals for EU Regulation on deforestation-free products (see chapter 3) and for a new law on corporate due diligence (see chapter 4) should be analysed in detail.

## 5.2.2 Stakeholders with influence on the approach

**European Commission (EU COM):** EU trade policy falls within the exclusive competence of the EU COM and applies to all EU member states. Directorate-General for Trade (DG TRADE) in the EU COM develops and implements EU trade and investment policy. The EU COM's work on trade policy is informed by guidance provided by member states.

Council of the European Union: The Council consists of representatives of member states' governments and decides on negotiation mandates and international agreements as well on trade policy measures. The Council's Trade Policy Committee assists the EU COM in trade agreement negotiations and advises it on trade policy. Ratification of EU trade agreements with third countries and legislative measures related to trade policy require approval by the Council of the EU and the European Parliament.

**European Parliament (EP):** The EP's Committee on International Trade (INTA) advises and monitors trade policy and all matters concerning foreign economic policy. Together with the Council of the EU, the EP ratifies EU trade agreements with third countries and legislative measures related to trade policy.

#### Stakeholders with influence on the EU Mercosur Agreement:

Parliaments of EU member states: Because the EU Mercosur Association Agreement covers more than trade issues (e.g. issues related to foreign policy, investment and intellectual property), EU member states must also ratify the agreement. (Waitz et al. 2021) Various EU governments and parliaments (Belgium, France, Ireland, the Netherlands and Austria) have opposed the ratification of the EU Mercosur FTA in its current form. One major impediment in finalising the ratification relates to environmental issues.

**National parliaments of Mercosur countries:** National parliaments of the four Mercosur countries must give their approval for the treaty to be ratified and implemented.

**European Parliament (EP):** The EP reiterated in October 2021 its position against the ratification of the EU Mercosur Agreement, "as it stands since, inter alia, it does not ensure biodiversity protection, in particular in the Amazon, nor does it bring guarantees as regards farming standards." (European Parliament 2021b)

Non-governmental organisations: Farmers' associations and civil society groups from Mercosur and the EU criticise the agreement because cheap agricultural imports endanger local agricultural production and the environment. The Stop EU-Mercosur Coalition, a transatlantic alliance against the EU Mercosur FTA made up of more than 450 civil society organisations and social movements from the EU and South America, launches petitions and writes open letters to stop ratification of the EU Mercosur FTA.

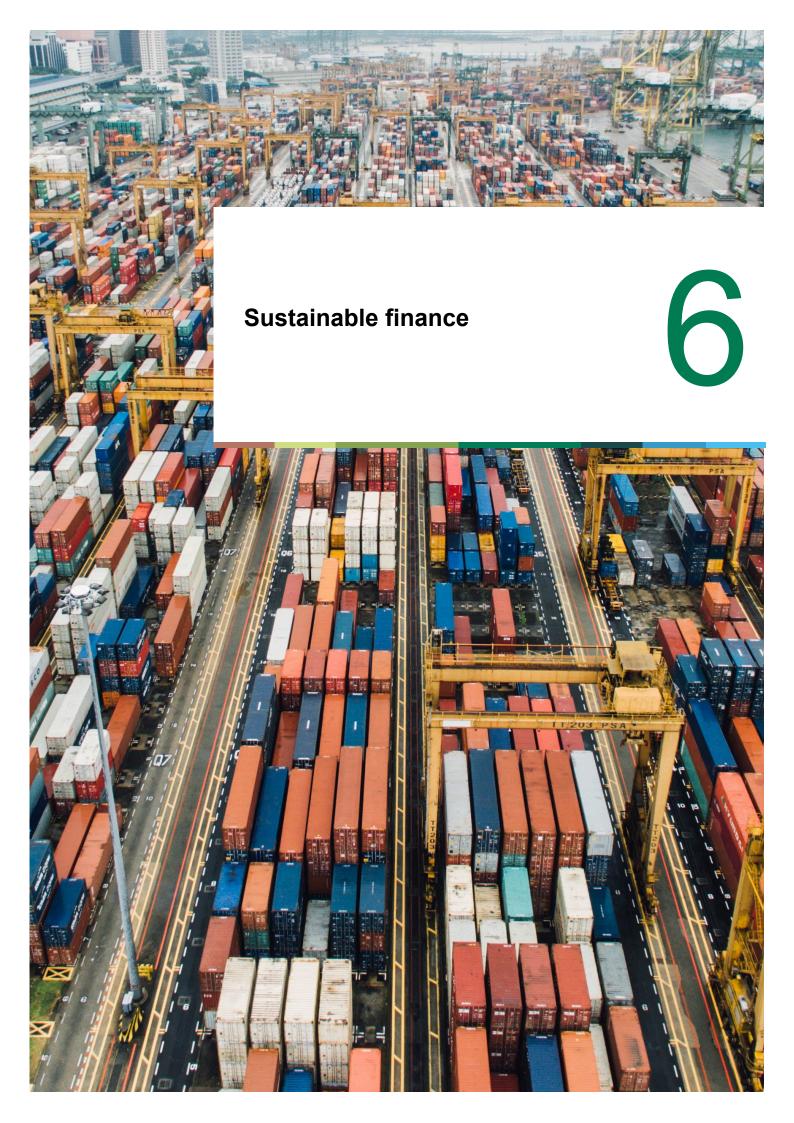
### 5.2.3 Current status and timeline

Valdis Dombrovskis, European Commissioner for Trade and Climate, confirmed in November 2021 at the 2021 United Nations climate change conference (COP26) that the EU will anchor the Paris Climate Agreement goals in future trade agreements. (Dombrovskis 2021)

#### **EU Mercosur Agreement**

In the last two years, negotiations have continued in order to reach agreement on sensitive pending issues, for example geographical indications of food products on which the parties still have differences. By September 2021, the agreement texts had not gone through the legal scrubbing process because negotiations on geographical indications had not yet been completed. After legal scrubbing, translation into the other 23 official languages will take place. A dialogue on addressing implementation of the Paris Climate Agreement and deforestation in particular is also ongoing. Furthermore, no decision has yet been taken on the legal framework of the agreement, i.e. whether the agreement will be split to enable separate approval of the trade chapter. For the ratification of the trade part only a qualified majority of the EU Council and approval by the EP is needed, but not approval by national parliaments. (Pineda 2021) As trade outside the EU is the exclusive responsibility of the EU, member states do not have to vote on the trade part. (Waitz et al. 2021) On other issues within the more comprehensive Association Agreement, such as foreign policy, investment or intellectual property, EU member states must have a vote. An Association Agreement including the trade part must be approved unanimously by the Council of Ministers. If approved by the Council, the agreement will be handed over for approval to the national parliaments of all EU member states. (Hoffmann & Krajewski 2021) This process may take many years. Therefore, it is difficult to foresee when a final agreement will be signed. (Montevideo Portal 2021)

As the French President Emmanuel Macron announced that he will not let this deal pass during his presidency, it can be assumed that the EU Mercosur FTA will definitely not be approved by the Council before the French elections in April 2022. (Moens and Leali 2021)



#### 6.1 What is sustainable finance?

The financial sector currently plays a key role in enabling extractive economic activities and the production of commodities that result in deforestation, especially in Mercosur region. Globally active banks and institutional investors from the European Union (EU), the United Kingdom, the United States and China indirectly earned an estimated \$1.74 billion over five years (2015-2020) through deforestation and environmental exploitation, according to a study by the non-governmental organisation (NGO) Global Witness (2021). Commercial and investment banks, asset managers and pension funds, private equity and insurance funds, all stand to provide finance to companies that operate and expand agricultural, forestry and mining businesses.

Banks and other financial institutions are intermediaries and capital distributors in the economic cycle and therefore have no direct influence on a company's business activities. However, they do have a great deal of leverage in deciding what they finance. If a coal-fired power plant or an agricultural plantation that drives deforestation can no longer find a bank that will refinance them, or only on very unfavourable terms, this indirect influence can play a major role in shaping business activities. The expectation of reputational damage that comes with increased transparency and obligations to assess and manage sustainability risks increase the pressure on financial institutions, which they consequently pass on to their borrowers.

The EU's financial sector as a whole could become a powerful force to help reduce deforestation. This could be achieved through a set of financial regulations and guidelines summarised under the term 'sustainable finance', which are not only or primarily concerned with deforestation, but a broad set of sustainability goals. According to the EU COM's Action Plan *Financing Sustainable Growth*, adopted in March 2018, sustainable finance aims to shift capital flows towards sustainable ends, achieve sustainable growth, and "assess and manage relevant financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and foster transparency and long-termism in financial and economic activity". (JCESA 2020)

Since the publication of the action plan, the EU has begun to develop legislation on the different elements of its sustainable finance strategy. The three most prominent of which are: the EU taxonomy, representing a classification system for sustainable activities; financial and non-financial institutions' disclosure about their financing or business activities; and institutions' risk management systems, aligned with and based on the Taxonomy Regulation. The taxonomy, as a uniform and credible standard, is expected to help increase transparency and comparability, avoid greenwashing, and ultimately (re)direct (private) financial flows towards green activities. In the process, financial and non-financial actors are exposed to (public) pressure to incur reputational damage by financing or engaging in unsustainable business practices (e.g. deforestation).

#### Table 1: Three pillars of sustainable finance

#### **TAXONOMY**

- The EU Taxonomy Regulation classifies sustainable activities (and specifies criteria and reporting requirements) for the purpose of sustainable finance. It applies to companies falling under the scope of the Non-Financial Reporting Directive (NFRD) and the proposed Corporate Sustainable Reporting Directive (CSRD), and to financial actors falling within the scope of the Sustainable Finance Disclosure Regulation (SFDR, see below on these regulations/directives) if the financial product on offer promotes sustainable characteristics.
- To be classified as environmentally sustainable, an economic activity must: 1) substantially contribute to one of the EU's environmental objectives; 2) do no harm to another (the 'do no harm criterion'); 3) comply with minimum safeguards; 4) and meet the technical screening criteria defined for each environmental objective and specified in separate Delegated Acts by the European Commission (EU COM). This catalogue/positive list of sustainable economic activities can serve as a strong guidepost to shift financing decisions.
- Companies will have to report on these indicators alongside their sustainability information mandated by the CSRD.
- At the time of writing this paper, a first delegated act for the two objectives of climate mitigation and climate adaptation has entered into force. A complementary climate delegated act was adopted in February 2022 and is awaiting non-objection from co-legislators, in which case it would become effective in the course of 2022. A further four objectives one of them being the protection and restoration of biodiversity and ecosystems are planned to be defined within the next year.

#### **DISCLOSURE**

- The EU COM's NFRD requires <u>large companies</u> (with more than 500 employees) to <u>publish</u> regular reports on the social and environmental impacts of their activities. It is currently on course to be amended by the CSRD in 2022. This would result, among other things, in a wider range of companies to which it applies (those with 250 or more employees and all listed companies).
- The SFDR defines disclosure obligations for all <u>financial market actors</u> to show how they integrate sustainability risks in their decisions and how they report their strategy, objectives and impacts accordingly.

#### **RISK MANAGEMENT**

- The assessment and disclosure of businesses' sustainability impacts and of the risk exposure of financial assets lay the groundwork for effective risk management. Accordingly, the EU's SFDR requires public assessment and reporting of sustainability risks, recognising a double materiality that is, the risk of financial harm (e.g. how can climate change harm the business model) and non-monetary but adverse impacts on sustainability (e.g. how can the business model harm the climate). A given company's business model could be subject to one, neither, or both types of risks.
- Without reliable, comparable and meaningful sustainability data from companies, investors
  and banks will not be able to incorporate long-term sustainability risks into their decisionmaking and thus redirect finance towards sustainable and future-proof investments.

## 6.2 SWOT analysis

To what extent can Sustainable finance contribute to reducing deforestation in global supply chains?

The EU's Sustainable finance agenda encompasses several parts that stand – at the moment of writing this paper – at different stages of either the legislative process or implementation. On the one hand, EU legislation on disclosure – i.e. Non-Financial Reporting Directive (NFRD) and Sustainable Finance Disclosure Regulation (SFDR) – has reached legislative closure and entered a roll-out trajectory amid ongoing debate about necessary improvements. On the other hand, the content of the taxonomy to classify sustainable economic activities remains unfinished and contentious. The main part of the taxonomy to address the two climate objectives of mitigation and adaptation has entered into force, while a complimentary delegated act concerning the climate-friendliness of nuclear and fossil gas is awaiting the scrutiny and approval of both the European Council and Parliament. Meanwhile, the EU COM's draft taxonomy to address the protection and restoration of biodiversity and ecosystems is only expected in 2022.

## **Strengths**



- Taxonomy Holistic and transformative, could set standard to be copied: The EU's action plan recognises that the shift of capital flows towards more sustainable activities has to be underpinned by a shared, holistic understanding of the environmental sustainability of activities and investments. Clear guidance on what qualifies as contributing to environmental objectives would help inform investment decisions. If the EU taxonomy provides this guidance in a rigorous, coherent and ambitious form, and finds the unified backing of EU colegislators, it could send a strong message and set standards to be copied by other countries who are developing their own taxonomies. Furthermore, the scheduled review of the taxonomy's technical screening criteria has the potential to ensure the efficiency of this tool in the long term.
- Taxonomy Inverse indication of the 'Do no significant harm criterion' as clear signal: The taxonomy has the potential to provide a rigorous framework to guide investment decisions covering all six sustainability goals. Those activities not included would automatically be defined as non-sustainable be it due to a lack of contribution to one sustainability goal or the fact that other goals might receive significant harm. An important condition for the taxonomy's positive effect is the ambitious and science-based definition of the underlying criteria (via the Commission Delegated Acts).
- Disclosure Sweeping potential of mandatory practices that are standardised and high-quality: Comparable and meaningful reporting (data) that is based on clear guidelines and indicators, based on legally defined thresholds and criteria, would allow companies' strategies and investors' decisions to gradually converge with the EU's sustainability goals, which include the preservation of ecosystems and biodiversity affected by global supply chains. Investment decision-making in particular could change at an escalating pace due to everhigher transparency. This would allow investors to better differentiate between companies' activities and discriminate against non-transparent and potentially risk-burdened enterprise activities.
- Transformative potential Shifting finance (like Foreign Direct Investment) goes beyond trade: Diverting finance from forest-risk commodities (FRC), e.g. in the Amazon region, by stringent sustainability regulations for EU-based financial actors could reduce deforestation rates beyond what is embodied and accounted for by EU imports of FRC. There is potential for significant influence on consumer goods companies, retailers and traders

upstream in value chains (WWF 2021, p. 53) if the practices/activities covered by the EU taxonomy were to apply in non-EU regions – including reporting directives to change financial flows.



Specific strengths regarding soy and beef supply chains from Mercosur

None.

#### Weaknesses



- Scope/applicability of reporting regulation: Some existing EU disclosure and reporting regulations currently apply only to a subset of the largest companies, thereby limiting their effectiveness. So far, they do not constitute a clear obligation to curb financing of businesses and assets that result in deforestation (or other adverse environmental impacts).
- Disregard of non-financial materiality and long-term risks: Financial risks are prioritised in assessment and disclosure stipulations over those risks that are material within the environmental/sustainability dimension and those that might only come to light in the mid or long term. This results in the sustainability risk remaining invisible to corporate decision makers and investors. A clear obligation to cover all three dimensions could alleviate this bias.
- Taxonomy without consequence: The taxonomy is initially just a label, a definition to distinguish sustainable from non-sustainable activities. The taxonomy guarantees that, for example, a sustainably investing pension fund really puts its money into sustainable securities and does not simply claim to do so. However, it does not prohibit investments that are labelled unsustainable, nor does it immediately make them less attractive in a comparison of the cost of capital.



Specific weaknesses regarding soy and beef supply chains from Mercosur

None.

#### **Opportunities**



- Momentum in sustainability/climate disclosure and accounting: There is a noticeable trend
  in the uptake of responsible investment and credit practices in the finance sector, where
  some influential actors are leading the way. Once a critical mass of voluntary early adopters
  and considerable targets of regulation are reached, sustainable finance may quickly become standard practice, penalising those who do not comply.
- International coordination on sustainability taxonomies: An increasing number of countries worldwide are working on national taxonomies to stipulate clearly what qualifies as a sustainable investment. Coordinated efforts could result in the adoption of rigorous, science-based guideposts for financial actors that are effective both inside and outside the EU.



**Specific opportunities regarding soy and beef supply chains from Mercosur** 

None.

#### **Threats**



- Political wiggle room: The prolonged struggle over the inclusion of gas and nuclear energy
  in the climate taxonomies exemplifies the political compromise and influence of vested interests that threaten rigorous and science-based legislative proposals. Moreover, a wide
  range of data sources and criteria for disclosure practices still remain unclear. Much will be
  dependent on which indicators work best in the context of the taxonomies and subsequent
  disclosure
- Varying implementation: National legislation on due diligence that has been adopted or is being discussed by member states cover different sectors and issues and as such may increase costs for companies operating across the EU. (Climate Focus 2019, p. 80) Especially for small and medium enterprises (SMEs) strong shifts may lead to higher costs of finance for non-complying producers, thus limiting their opportunities to catch up and take up more sustainable practices. (WWF 2021, p. 53)
- Lacking compliance with disclosure concerning human rights and environmental due diligence: This type of disclosure is already required under the EU NFRD, but only about 1 in 5 companies fulfil this requirement, according to independent findings of several actors (see Germanwatch et al. 2021).



Specific threats regarding soy and beef supply chains from Mercosur

None

#### 6.2.1 Recommendations

To shift international financial flows that originate in the EU away from activities that drive deforestation and towards more sustainable land-use practices, several tools need to be put into practice and evaluated in a coordinated manner. They address the three central points of transparency, risk management, and guidance. Table 2 summarises the main recommendations for these three main tenants of sustainable finance to help curb deforestation that results from EU supply chains.

Table 2: Recommendations for sustainable finance to achieve deforestation-free supply chains of forest-risk commodities (FRCs)

RECOMMENDATION	redesign considerations
Move from voluntary to manda-	Increase overall transparency, comparability and quality
tory disclosure	of disclosures. Standardisation could result in lighter ad-
	ministrative burden for companies, e.g. within the CSRD.
	Harmonise disclosure obligations by aligning domestic
	requirements with a common disclosure framework.
	Provide detailed metrics for reporting on forests, soil and
	biodiversity impacts within the CSRD.
	Include highly relevant (high-risk) SMEs in CSRD report-
	ing obligations independent of whether they are listed or
	not.

Enhance risk management	Adopt (through legislation or supervisory guidance) more
_	
frameworks for the land sector	comprehensive risk management controls for financial ac-
	tors.
	Integrate scenario analysis and climate-related stress tests
	(that also cover the agricultural sector) into supervisory ap-
	proaches.
	Impose a legal duty of care and mandatory due diligence
	for financial system actors which addresses the risk of de-
	forestation within global commodity supply chains.
Active promotion of climate-	In the upcoming taxonomy delegated act for biodiversity,
aligned finance to the land sec-	provide stringent definitions of sustainable activities in the
tor	land sector. Criteria, thresholds and benchmarks must be
	science-based and ambitious enough to lead to greater
	sustainability than the status quo.
	Develop green lending guidance that covers the agricul-
	tural sector.
	Increase lending limits for farmers and companies that
	provide evidence of being climate-aligned.

Source: Climate Focus 2021, p. 4, adapted from UN-Habitat 2008, UN-Habitat 2009.

#### 6.2.2 Stakeholders with influence on sustainable finance

The European Commission (EU COM): The EU COM is in the process of compiling a list of environmentally sustainable activities by defining technical screening criteria for each environmental objective through delegated acts and implementing acts under the Taxonomy Regulation. Furthermore, the EU COM made the proposal for the Corporate Sustainability Reporting Directive (CSRD), aiming to put sustainability reporting on a par with financial reporting in the long term. Individuals involved in this process, who are also part of the College of Commissioners that adopt delegated acts, include Mairead McGuinness, Commissioner responsible for financial services, financial stability and the Capital Markets Union and Valdis Dombrovskis, Executive Vice-President for an Economy that Works for People.

**EU Council/member states:** As with any delegated act, EU member states in the Council of the EU can only reject the text by qualified majority. Prior to the formal scrutiny process, the Council, along with the European Parliament (EP), was involved in the development of the taxonomy, for example by suggesting additional conditions for activities to qualify as aligned with the taxonomy. Regarding the CSRD proposal, the EU COM engages in discussions with the Council and the EP, the two co-legislators, who will ultimately have to agree on and approve the final text of the directive.

**European Parliament (EP):** After its formal adoption by the College of Commissioners, the taxonomy delegated act are subject to scrutiny by the EP and the Council. The EP may object to a delegated act by absolute majority of its members, but cannot amend it. Prior to the formal scrutiny process, the EP had already taken some action to support the process, for example by insisting on making it mandatory for companies covered by the existing NFRD to publish information on the alignment of

their activities with the taxonomy; this resulted in the EU COM proposing the new CSRD. Furthermore, the EP played an important role in bringing 'transitional' and 'enabling' activities into the discussion. Regarding the CSRD Proposal, the EP now has to find agreement with the Council, based on the proposal by the EU COM (see EU Council).

The **EU Platform on Sustainable Finance**, established by the EU COM in 2020, is advising the EU COM in this process. This permanent expert group is composed of a wide range of stakeholders from the private and public sector, including private stakeholders from financial, non-financial and business sectors, academia, NGOs, civil society and public institutions. (European Commission 2021)

**Sustainable Finance Technical Expert Group (TEG SF):** In order to inform its work on the action plan, including on the EU taxonomy, the European Commission established the <u>TEG SF</u> in July 2018. Within the framework of the Taxonomy Regulation, it developed recommendations for technical screening criteria for economic activities. The TEG SF was the predecessor of the EU Platform on Sustainable Finance.

The Sustainable Finance Committee of the German federal government advises the German government with the aim to make Germany a leading hub for sustainable finance. In its final recommendations under the previous government in 2021, the Committee recognised the importance of sustainability-related disclosure and governance. The new government has agreed in the coalition treaty that the Committee shall continue its work in the next years.

#### 6.2.3 Current status and timeline

The EU has taken some important first steps to facilitate financing decisions that protect forests and ecosystems worldwide, and additional steps have been announced. In 2021 these included a proposal for the Corporate Sustainability Reporting Directive (CSRD) affecting companies' disclosure practices and the further definition of the EU taxonomy. The first taxonomy delegated act provides financiers with a tool to classify sustainable economic activities – although so far only in terms of their climate impacts. A proposal to consider biodiversity is being developed and expected for 2022. This could play an important role in curbing deforestation resulting from global supply chains if it is developed on a rigorous scientific basis and not weakened by lobby interests.

Member states have exerted their influence on what is included in the taxonomy. In the first Climate Delegated Act, several member states criticised the inclusion of criteria for forestry stating, "forestry should remain within the competences of the member states". (Finnish Government, 2021) Finland, Sweden and others would have needed to gather a corresponding majority of 65% of the total EU population (i.e. 13 member states) in order to reject the proposed delegated act. They did not success in doing so, so the delegated act was not rejected by the EU Council after an extended scrutiny period and entered into force. However, the criteria for forestry and energy for biomass as agreed are being criticized by many experts, who believe they were watered down due to the influence of member states trying to protect their forestry industry.

Recent rows between EU members over the inclusion of gas and nuclear technology within the taxonomy on climate change mitigation also indicate that EU sustainable finance regulations are not immune to the individual interests of powerful Member State, notably France and Germany. The European Commission's proposal now included nuclear and fossil gas under certain conditions. It is still possible that the delegated acts is rejected by absolute majority within the EP. But even then, the EU taxonomy stands to lose credibility as a rigorous and science-based tool – and in comparison to taxonomies developed by other countries.

In addition to the EU, other countries and international companies have also recognised the importance and potential of sustainable standards and are beginning to develop their own. Here too, it is important that science-based guidelines are not weakened by the political pressure of a few.



## 7.1 What are voluntary corporate commitments?

In the late 2000s, increased pressure on major corporations led to several individual or joint declarations and commitments by companies and financial institutions to reduce and halt deforestation in their supply chains. In the New York Declaration of Forests (NYDF) 2014 more than 200 governments, companies, non-governmental organisations (NGOs) and Indigenous communities declared the legally non-binding goal to halve the loss of forests by 2020, and to end it completely by 2030.

In 2015, in the context of the Paris Climate Agreement, a group of European countries launched the Amsterdam Declarations Partnership, which aims to support the private sector in achieving deforestation-free sustainable supply chains. By 2019, 484 (56%) of the 865 companies with forest-risk exposure had made sustainable commodity commitment(s) regarding forest-risk commodities (FRCs) in their supply chains. (Rothrock et al. 2019)

There are different types of voluntary corporate commitments on zero-deforestation, for example: individual company or group-level adoption of voluntary standards or codes of conduct that define specific production or sourcing practices; sector-wide supply chain-based interventions such as agreed principles, criteria and forms of verification to halt deforestation; and mixed supply chain and territorial initiatives at jurisdictional level. (Pacheco et al. 2018) (Lambin et al. 2018) The success of those commitments differs from commodity to commodity. While palm oil in recent years has globally been increasingly incorporated into zero-deforestation practices in the private sector, soy and especially beef have not yet been effectively addressed. (Pacheco et al. 2018) In the last few years, after companies failed to reach their 2020 targets, initiatives like the Consumer Goods Forum (CGF) shifted from deforestation-free to a broader forest-positive approach. (The Consumer Goods Forum 2019)

Within the Brazilian soy sector, one of the major drivers of deforestation in Mercosur, there are four important multi-stakeholder commitments so far: the Amazon Soy Moratorium, NYDF, the Amsterdam Declaration, and the Soft Commodities Forum. Additionally, the five largest soy traders (Bunge, Cargill, Amaggi, Louis Dreyfus, and Archer Daniels Midland), who together account for over half of Brazilian soy exports, made zero-deforestation commitments. (Lambin et al. 2018) Within the Brazilian Soy Moratorium (2006) and the following Cattle Agreement (2009) commodity traders agreed to avoid the purchase of commodities produced in the Amazon biome after certain cut-off dates.

These commitments comprised 90% of the soy exported from the Amazon and led to a drastic reduction in deforestation in the Amazon region. Nevertheless, there were several leakage effects. In particular, in the Cerrado, a vast dry and hot savannah eco-region, deforestation increased due to commitments to reduce deforestation in the Brazilian Amazon region. In the Cerrado less than half of the soy was traded by companies with deforestation-free commitments. (Ermgassen et al. 2020) With the Cerrado Manifesto (2017) more than 150 companies and financial institutions committed to support a halt to deforestation in the Cerrado. (FAIRR 2018)

Those agreements illustrate a rising awareness among companies of the negative impacts of deforestation and are accompanied by funding strategies to create more effective agricultural production

that uses less land while increasing production per hectare. It has been acknowledged that continued growth in agricultural production and increase in food security are possible while halting and reversing deforestation. (Committee on Forestry 2020)

The public commitments are part of corporate social responsibility strategies, where companies try to meet the ecological and social expectations of society and a growing number of investors. They are translated into deforestation and sustainability strategies by the corporates. Certification schemes are often employed to increase traceability and transparency, as well as to communicate the efforts to consumers and the financial market. The criteria for deforestation-free certification schemes widely differ in their demands. (Hargita et al. 2018) Additionally, several non-governmental institutions, often financially supported by governments, provide traceability tools and surveys to monitor and evaluate the performance of corporates regarding their deforestation commitments. Benchmarking criteria like the Accountability Framework (see below) developed by a coalition of civil society actors like the Rainforest Alliance and experts provide social as well as ecological criteria and aim to close the gap between commitments and their results. (Accountability Framework Initiative, n.d.)

# 7.2 SWOT analysis

To what extent can voluntary corporate commitments contribute to reducing deforestation in global supply chains?

The difficulties in analysing and evaluating voluntary commitments to remove deforestation from supply chains are, that they involve a wide range of companies, commodities, supply chains and geographical regions, as well as different scopes, timelines, and varying transparency. Additionally, many of the commitments have only recently been made and interact with different other factors and instruments.

## **Strengths**



- Deforestation commitments can be easily adjusted and are more flexible than legal instruments and thereby might have a growing potential to affect multiple commodities and regions
- Voluntary corporate commitments provide a vision of change for the private sector, which is easy to communicate with the broader public. At the same time voluntary corporate commitments can be tailored to a company's or region's needs.
- Combination with other instruments and policy measures is easily possible and corporate commitments incentivise traceability, transparency and accountability of private companies.



Specific strengths regarding soy and beef supply chains from Mercosur

None

#### Weaknesses



- No legally binding mechanisms: voluntary commitments so far have failed to eliminate deforestation from agricultural supply chains by 2020 failed without any consequences.
   (CDP 2021) The private sector has acknowledged that cleaning up individual supply chains based on certification systems is not enough and that voluntary commitments alone have failed to reach their targets. (The Consumer Goods Forum 2019)
- Weaknesses in their implementation: Most commitments lack a clear blueprint for implementation. (Ermgassen et al. 2020) Only a quarter of member companies of the Consumer Goods Forum (2016) had developed their own quantified and time-bound action plan to reduce deforestation and put measures in place to ensure compliance along their supply chain. (Lambin et al. 2018) This makes them a potential tool for greenwashing; as commitments are not framed by legally binding agreements and not necessarily independently monitored, they can be used to improve a company's image.
- Lack of monitoring: More than one-third of the 500 most influential companies and financial institutions in key forest-risk supply chains with a deforestation commitment have not reported on their progress towards that commitment in the past two years. (Thomson 2020) Their commitments often do not include traceability and transparency aspects, (Jopke and Schoneveld 2018) which makes it difficult to hold companies accountable. Additionally there are many difficulties in the traceability of certain commodities. Deforestation-risk products such as beef and soy are traded in global supply chains along multiple tiers. Therefore it is difficult to trace the various stages in the supply chain and ensure that the products come from verified deforestation-free sources. (Ermgassen et al. 2020) The control is also limited through the lack of common certification standards. The certification criteria differ among the commitments and many voluntary certification standards cannot fully guarantee deforestation-free products. (Hargita et al. 2018) (Sydow and Reichwein 2018) Additionally, some certification systems use mass balance systems, which allow uncertified producers to participate in certified chains. (Jopke and Schoneveld 2018)
- The specific focus of commitments on individual supply chains, biome and standards is associated with strong leakage effects and lead to a selective adoption of zero-deforestation strategies. The focus on deforestation only in certain ecosystems and commodities, as well as a limited or unclear definition of deforestation, can lead to increased land use in other ecosystems such as farmlands, grasslands or wetlands –thereby risking indirectly driving deforestation. Those fragmented actions are not adequate for the global challenges of biodiversity loss and climate change.
- Lack of commitments on the part of companies and financial institutions for all markets: Almost half of the 500 most important companies and financial institutions do not have deforestation-free commitments. (Thomson 2020) Voluntary commitments are also dependent on market demands. Through the reorientation of trade patterns towards regions with less stringent deforestation regulations, parallel supply chains could emerge and limit the effects of deforestation interventions that target only one market.
- In particular, socially detrimental externalities are seldom part of deforestation commitments and it is less likely that more commitments with a broader socio-ecological scope will solve the problems that their zero-deforestation commitments threaten to produce. Country laws are often weak, contradictory and poorly enforced, which is moderated by the capacity of public agencies and corruption. (Jopke and Schoneveld 2018) Companies often fail to explicitly account for the socially damaging externalities of their commitments, especially to applying free, prior and informed consent (FPIC) principles of land acquisition, to conserve forest lands or account for possible indirect land use changes. (Jopke and Schoneveld 2018) The commitments could also have potential disadvantages for smallholders and small companies by strengthening the positions of powerful actors and excluding smallholders and Indigenous groups from market access. High logistic boundaries and the cost of complying with environmental

and social standards might push small companies to less demanding markets – or drive them out of business.



# Specific weaknesses regarding soy and beef supply chains from Mercosur

- While in the Brazilian soy sector corporate commitments are increasing, certain regions like the Cerrado or Gran Chaco where most soy-associated deforestation currently takes place, (Ermgassen et al. 2020) are underrepresented. Cattle supply chains in general is under-represented in the commitments, although ranching is the largest driver of deforestation. For soy, 63% of 30 companies had some kind of deforestation policy, accounting for 11% of total global soy production. For cattle products, 18 of 25 companies (72%) had deforestation policy, which makes up 11% of total global cattle meat production. (Garett et al. 2019) But even if there are commitments, they do not necessarily affect deforestation rates. There has been no reduction in the soy deforestation in the Cerrado since commitments were made. (Ermgassen et al. 2020)
- Leakage from the Amazon into the Cerrado: Soy continues to be a major driver of habitat loss in the Cerrado's Matopiba region (made up of the states of Maranhão, Tocantins, Piauí and Bahia), where over the last decade 0.5–0.8 million hectares of soy each year has been planted on recently converted land. (Ermassen et al. 2020)
- By 2014, Cattle Agreement 2009 had had no average impact on forest cover in the regions
  around important slaughterhouses in Mato Grosso and Pará. This was due to leakage to
  nearby properties and the poor reliability of data provided to track the origins of beef from
  indirect suppliers. (Lambin et al. 2018)
- Certification criteria differ: Only five of 16 popular soy certification schemes can fully guarantee zero-deforestation. (Hargita et al. 2018) More than 85% of companies with deforestation commitments (2015) in the palm, timber, soy and cattle supply chains used third-party certification to monitor the commodity supply. (Lambin et al. 2018)

### **Opportunities**



- Targets with immediate implementation deadlines and accompanied by sanction-based implementation mechanisms could help save biomes at risk of reaching tipping points through land conversion. (Garett et al. 2019) Rising corporate accountability for their environmental impacts along supply chains in general could lead to more sustainable trade and economic benefits. Corporates enrolled in programmes with sustainability requirements value different benefits, such as improved market access and non-monetary benefits, including greater efficiency, higher yields, technical aid and access to information. (Lambin et al. 2018) Public-private assistance and tools for deforestation-free supply chains are supporting change. Improvement of traceability could help reduce deforestation and support implementation of commitments.
- Effective on-the-ground actions and supportive public policies could lead to effective implementation. Research suggests that government regulatory quality and action predicts the effectiveness of corporate sustainability approaches, such as in the palm oil sector (2015) in Kalimantan (Indonesia). (Lambin et al. 2018) Clarifying property and land rights jointly with local authorities could help implementation of commitments, mitigate negative social-effects, and potentially share costs and risks. (Lambin et al. 2018) Ensuring land rights and increased land ownership among Indigenous and local people will support sustainable forest management.
- Increased demand-side measures and global demand for sustainable products could create new incentives for corporates to commit to zero-deforestation and implement their strategies.
- Sustainable finance and investing guidelines could support companies in the transition, and create more and better forest governance structures. (Lambin et al. 2018)

Other supply chain actors could join the commitments and create cascade effects in different sectors throughout the supply chain. Producers would be required to align their practices to more stringent procurement standards and commitments. Inclusion of more companies, regions, commodities and supply chains could reduce leakage of deforestation and have positive spillover effects and nudge a more sustainable development. The palm oil industry could thereby be a positive example. (Jopke and Schoneveld 2018)



# Specific opportunities regarding soy and beef supply chains from Mercosur

Brazil's satellite-based forest monitoring has been essential to efforts by companies to
monitor their supply chains as well as to effectively implement programmes to decrease
deforestation. Non-profit platforms like Trase further use this data to improve transparency
about exports. (Lambin et al. 2018) Further development of reliable traceability and transparency mechanisms would profit deforestation-free supply chains.

#### **Threats**



- New official commitments from corporates and countries, for example the COP26 Forestry
  Agreement, replace old and partially failed declarations like the New York Declaration on Forests (NYDF) and announce less ambitious goals. (UN Climate Change Conference UK 2021a)
- Changing global market demands reduce the share of sustainable demand and thereby production, with the Chinese market becoming more and more important.
   Parallel marketing allows companies to create different trading systems according to the demands while not limiting net deforestation.
- Narrowing the supply base to a smaller number of producers who have the capacity to
  conform to production and tracing standards would disadvantage small-scale farmers and
  create further monopolisation of the market, which would further exclude smallholders
  from supply chains. Smallholders face high certification barriers; thereby making certification principles and criteria more stringent. Inevitably this will disproportionately disadvantage smallholders. (Jopke and Schoneveld 2018)



# **Specific threats regarding soy and beef supply chains from Mercosur**

- With a growing local market, as is the case for beef, more than 80% of deforestation was
  attributable to domestic demand. Despite such certification schemes having become the
  benchmark for good social and environmental practice in various sectors, they govern only
  a small proportion of global production. Fading public attention to the issue and limited
  public awareness of biomes like the Cerrado or the Gran Chaco limits corporates ambitions
  and accountability.
  - Trade agreements like the EU-Mercosur trade agreement could increase exports of forest-risk commodities and increase difficulties in monitoring and implementing sustainable agricultural practices. (Kehoe et al. 2020) The EU-Mercosur trade agreement in its current form lacks legally binding mechanisms to enforce sustainability criteria along the supply chains. It is therefore not incentivising companies to comply with zero-deforestation strategies and is putting additional pressure on smallholders and Indigenous people.
- Use of GMO, technologies and pesticides and the further legalisation of those practices in Mercosur and EU to raise effectiveness of agricultural production on already degraded land to halt deforestation of new areas could have negative health, social and environmental effects. (Teller et al. 2020)

#### 7.2.1 Recommendations

So far, the effects of voluntary corporate commitments to remove deforestation from supply chains on a large scale have been limited and deforestation in recent years has increased, especially outside of the Amazon biome. In the Amazon biome deforestation drastically increased after 2019, when Jair Bolsonaro took office as president of Brazil. (Instituto Nacional de Pesquisas Espaciais 2021) Crosssectoral declarations like the NYDF have so far failed to reach their own targets, and recent reports claim that members of the NYDF are not yet on the path to achieve their future deforestation goals either. (New York Declaration on Forests 2021b) The lack of legally binding mechanisms and reliable monitoring and traceability criteria, as well as the still fragmented cooperation with local authorities and public policies, hinder effective implementation of corporate commitments. Large loopholes in the scope, implementation and monitoring of the commitments have led to increased pressure on several ecosystems of the Cerrado or Gran Chaco in the past years. These loopholes urgently need to be closed, as ecosystems like the Gran Chaco are close to reaching irreversible tipping points. (Law et al. 2021) For voluntary corporate commitments to be more efficient they would need to be translated into strategic plans with concrete goals covering all high-conservation value areas, commodities and supply-chain stages. Even then, the effectiveness of voluntary commitments remains limited, as not all companies participate, and accountability, let alone binding enforcement, is lacking even for those who do participate.

Research suggests that outcomes from zero-deforestation initiatives would improve if they were complemented by public policies tailored to local context that would allow ongoing monitoring and verification. (Lambin et al. 2018) There is a need for better cooperation with local authorities and state institutions in producer countries, as well as for a reliable and legally binding framework to accompany implementation. Voluntary corporate commitments on deforestation need to be supported by the state through monitoring, sanctioning and registering landholdings. (Jopke et al. 2018)

Several public-private partnerships and civil society organisations are creating valuable tools to support monitoring (e.g. Forest 500), tracing (e.g. Trase), establishing socio-ecological criteria (e.g. the Sustainability Accountability Framework), and introducing reliable certification schemes. The effects of voluntary corporate commitments are largely determined by institutional innovation and legally binding frameworks, like the EU framework to halt and reverse deforestation.

## 7.2.2 Stakeholders with influence on the approach

The NYDF gathers companies, countries and civil society initiatives – and with its assessments provides an important platform to evaluate progress on those goals. The 'Glasgow Leaders Declaration on Forests and Land Use' similarly was signed by relevant forest producer and consumer countries and could become important in prioritising deforestation-free supply chains in transnational policies and supporting the commitments. With the Glasgow Declaration on Forests and Land Use ten leading agricultural commodity companies<sup>2</sup> issued a joint statement and roadmap for "enhanced supply

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<sup>&</sup>lt;sup>2</sup> Later two more companies joined.

chain action consistent with a 1.5 degrees Celsius pathway," including the commitment to halt deforestation associated with agricultural production. (UN Climate Change Conference UK 2021b)

The Consumer Goods Forum (CGF) is a platform of companies which set zero net deforestation targets, (Following the WWF definition of zero net deforestation: The Consumer Good Forum 2016) but which has so far not found a mechanism to ensure implementation. The Sustainable Trade Initiative (IDH) is public-private partnership which, by bringing together over 600 businesses and government, aims to provide tools to shift to more sustainable supply chains. (The Sustainable Trade Initiative n.d.) Widespread guidelines include the Accountability Framework from the Accountability Framework Initiative (AFI) and the Soy Sourcing Guidelines from the European Feed Manufacturers' Federation (FEFAC). (European Feed Manufactors Federation 2016) There are many more public-private partnerships, roundtables and initiatives to support responsible soy sourcing, for example the Sustainable Agriculture Network (SAN) or the Tropical Forest Alliance (TFA).

Civil society-led initiatives, as well as NGOs like the WWF and Greenpeace, have so far been playing an important role in holding companies accountable to their commitments, highlighting best practice examples and communicating the issue to consumers.

Some European countries, such as Germany, established country-specific guidelines for deforestation-free supply chains, (BMEL 2021b) which aim to "Promote and support initiatives by business, civil society and associations for deforestation-free supply chains of agricultural raw materials on the production and consumption side." (BMEL 2020) Furthermore, Germany set up a national stakeholder forum to support the implementation of the guidelines. (BMEL 2021a) Many European countries are part of the Amsterdam Declarations Partnership as well as the Glasgow Declaration on Forests and Land Use, which is also supported by China and Brazil. Some stakeholders from Mercosur emphasise the importance of non-regulative initiatives and to foster further economic growth in the region, (Aprosoja 2021)<sup>3</sup> while Indigenous and human rights focused stakeholders remain sceptical of voluntary commitments, as they do not adequately include solutions for human right violations or violent land right conflicts. (FIAN 2018)

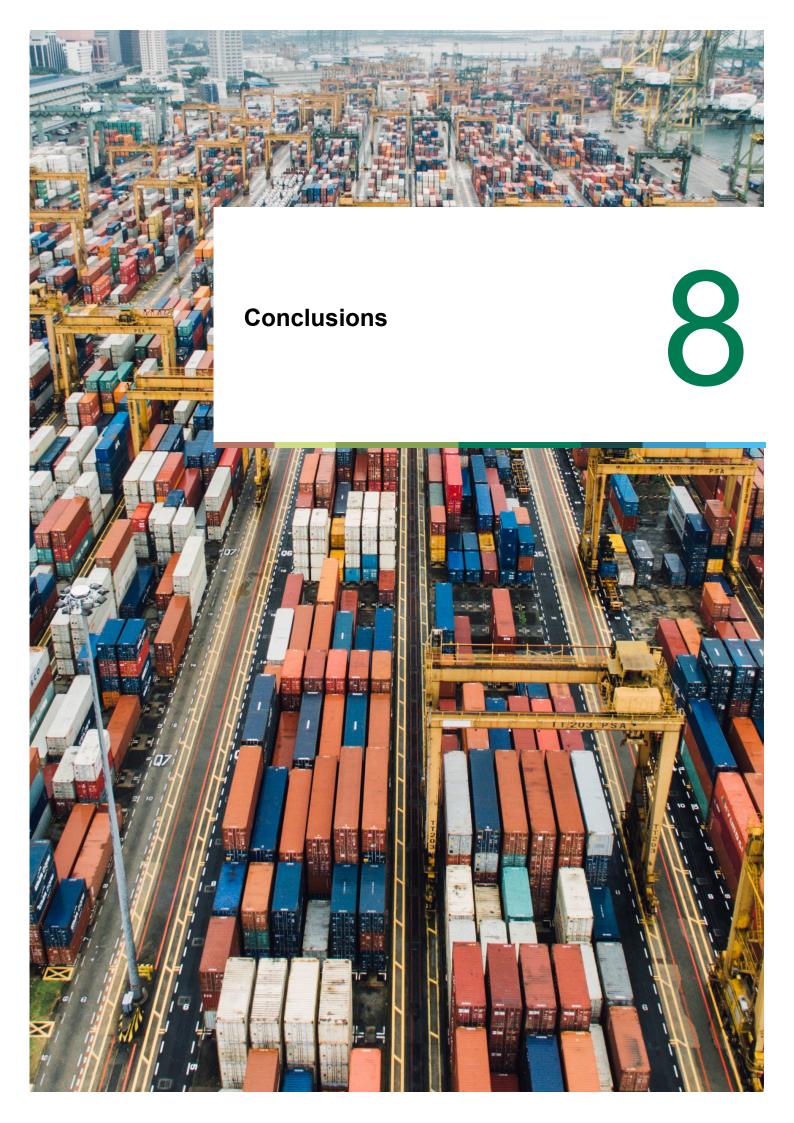
#### 7.2.3 Current status and timeline

The NYDF seeks to halt natural forest loss by 2030 as well as to restore 350 million hectares of degraded landscapes and forestlands. (New York Declaration on Forests 2021a) With the Glasgow Leaders' Declaration on Forests and Land Use the countries who together cover more than 90% of the world forest area made a commitment "to halt and reverse forest loss and land degradation by 2030 while delivering sustainable development and promoting an inclusive rural transformation". (UN Climate Change Conference UK 2021a) Many companies, such as Cargill, that signed the NYDF and additionally set internal goals on deforestation, have mostly set 2030 as finishing point for implementation of zero-deforestation and affirmed their ambition in the Agricultural Commodity Companies Corporate Statement of Purpose in November 2021. (UN Climate Change Conference 2021b) Recently, deforestation in the Cerrado region has become more and more prominent and therefore

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<sup>&</sup>lt;sup>3</sup> As told to the author in an Interview with the Nature Conservancy and an Interview with Alejandro Brown (ProYungas).

led to commitments regarding this region. Scientists are now particularly concerned about the Gran Chaco as well, as only a small part of the Gran Chaco is legally defined as forest or under conservation. Therefore it is often not clear whether voluntary corporate commitments cover deforestation and land degradation in the transnational Gran Chaco region, which is becoming very close to reaching an irreversible tipping point that would critically damage biodiversity and the balance of the ecosystems. (Law et al. 2021)



#### How the EU can promote deforestation-free supply chains

Global deforestation is an urgent problem that the European Union (EU) needs to address. Global climate and biodiversity goals will become unattainable if deforestation continues at current rates. In addition, deforestation is often associated with very serious human rights violations. As the world's second largest importer of forest-risk commodities (FRCs), the EU significantly contributes to this problem and has a responsibility to act. This would reflect the EU's often-stated commitment to protect human rights, contribute to limiting global warming to 1.5°C and protect global biodiversity.

Voluntary corporate commitments as they exist today are not sufficient to address the problem. On the one hand, they cover only those companies that have signed up to them, leaving some parts of the market uncovered. On the other hand, such commitments lack transparency, accountability and enforcement. Nonetheless, voluntary initiatives and civil society activity on these initiatives have led to greater awareness and better tools for tracing and tracking, and these can now be used in the development of more binding approaches that have wider coverage.

An appropriate response by the EU should set binding rules to address both the specific problem of imports linked to deforestation as well as the broader systemic drivers of corporate responsibility, finance and trade. The EU is pursuing several policy initiatives that are at different stages of development and could all help curb deforestation. In the face of ecosystems threatening to collapse, it is crucial to integrate measures to prevent deforestation into all future policies. These policies should be consistent with each other and can complement one another. By its nature, a Regulation on deforestation-free products will be focused on certain products and maybe specific geographies only. It will make an important contribution to solving the problem, although some loopholes will remain even if the regulation is well designed. These can be addressed by a strong EU Sustainable Corporate Governance legislation covering all sectors and requiring most companies to assess and reduce risks in the entire value chain, not limited a priori to certain products or geographies. Similarly, comprehensive sustainable finance frameworks can address finance as an enabler of deforestation in a much broader way. Finally, reformed trade rules would address another systemic driver of deforestation and could set incentives for better forest governance, not only with respect to agricultural commodities exported into the EU.

The upcoming Regulation on deforestation-free products should prevent goods from entering or leaving the EU domestic market that are either linked to deforestation or forest degradation or to the conversion of other natural ecosystems with high ecological or social importance. The list of FRCs covered by the regulation should include from the outset rubber, maize and all livestock-containing products. Goods should be deemed 'deforestation-free' with a cut-off date before 2008 instead of 2020. Furthermore, the regulation should ensure effective prosecution and specify fines to provide deterrence. Third parties should be given a legal remedy in the case of impairment due to deforestation or forest degradation. Compliance with international standards of human rights should be a prerequisite for placing products on the EU market. Due diligence obligations should apply to operators and large traders of FRCs as well as to financial institutions regardless of the country of origin of the FRC.

A strong EU legislation on environmental and human rights due diligence is needed to complement the product-specific approach of the regulation on deforestation-free products. The upcoming due diligence legislation (which forms part of the so-called Sustainable Corporate Governance initiative) should introduce broad, horizontal obligations for businesses to monitor their own operations as well as their value chains for environmental and human rights risks. It can effectively complement the product-specific regulation on imported deforestation, if, in addition to human rights due diligence, it includes a clearly-defined and comprehensive environmental due diligence obligation. Moreover, in order to fully address deforestation risks, the legislation needs to cover the entire value chain as well as companies of any size, including small and medium-sized enterprises (SMEs) where these operate in a risk sector. Lastly, the rights of affected people for public participation and access to justice must be upheld. This must include the possibility to claim compensation before a European court and from a company that has infringed its due diligence obligations. This would be a strong legal tool that is not foreseen in the Regulation on deforestation-free products.

The EU should contribute to a shift of international financial flows away from activities that drive deforestation and towards more sustainable land-use practices by developing comprehensive sustainable finance frameworks. The EU should include considerations regarding the protection of forests and other ecosystems in its forthcoming legislation regarding transparency, risk management and guidance as follows: First, the EU should pursue a gradual and consistent move towards mandatory disclosure that harmonises obligations and provides detailed metrics for reporting on forest conservation, biodiversity and land use within the Corporate Sustainable Reporting Directive (CSRD). Second, risk management frameworks for financial actors in the land sector should be developed and streamlined, including the integration of scenario analysis and climate-related stress testing. Third, concerning the Taxonomy Regulation, the delegated act for biodiversity should provide science-based and ambitious criteria to identify sustainable activities.

EU trade agreements should contribute to deforestation-free supply chains through enforcement mechanisms that ensure compliance with environmental and labour commitments. EU trade agreements should include legally binding commitments specifically addressing deforestation-free production of FRCs and obligations on all operators and investors trading FRCs to adhere to due diligence standards. In addition, they should include commitments by the EU to provide technical and financial assistance for the transition towards sustainable production of FRCs and the implementation of verifiable and effective forest conservation policies. New EU trade agreements must contain a binding state-state dispute settlement with respect to the sustainable development provisions.

While these instruments are being developed, the EU should refrain from measures that make the problem worse, such as a further liberalization of agricultural trade without appropriate safeguards. Specifically, the EU should not ratify the EU-Mercosur free trade agreement (FTA), which risks further increasing the traded volume of FRCs without necessary safeguards to protect the climate, biodiversity and human rights. The FTA should be renegotiated to remedy serious shortcomings regarding environmental and human rights protection associated with deforestation. In particular, a renegotiated trade EU-Mercosur FTA should include a binding enforcement of the Trade and Sustainable Development (TSD) chapter with clear sustainability obligations, effective implementation measures and an applicable dispute settlement mechanism.

In order to be most effective, EU action should be embedded in a cooperative international strategy that engages producer countries as well as other large consumer markets. The EU should engage producer countries in continued dialogue on jointly curbing deforestation. Such dialogue should include not only government officials, but also civil society experts and representatives of affected communities and Indigenous peoples. In addition, the EU needs to offer support to producer countries to improve forest governance and monitoring and to develop viable economic alternatives. The EU should also engage in a dialogue with other large consumer markets, such as China. The objective should be to secure joint commitments to address imported deforestation and coordinate where possible the design of such measures. In addition to bilateral dialogue, forums such as the G7 and G20 should be used to advance this discussion. The EU should also support the creation of a follow-up process to the Glasgow Leaders' Declaration on Forests and Land Use that would create an accountability mechanism for the commitments made by 141 countries at COP26 to halt and reverse forest loss and land degradation by 2030.

# **Glossary**

Amazon Soy Moratorium	A sectoral agreement signed in 2006 under which commodity traders committed not to buy soybeans from areas in the Amazon region that were deforested after 2008.
Amsterdam Declarations Partnership	Political commitments of nine countries launched in 2015 aimed at supporting the private sector to implement commitments on promoting deforestation-free, sustainable commodity production and trade and to eliminate deforestation in relation to agricultural commodities by 2025.
Association Agreement (AA)	Legally binding agreement between the EU and third countries.
Biome	A naturally occurring community of flora and fauna in an extensive area.
G4 Cattle Agreement	Moratorium agreed by four of the world's largest cattle producers and traders to not purchase cattle from areas of the Amazon rainforest deforested after 2008, from ranches using slave labour or illegally occupying protected areas and Indigenous reserves.
Glasgow Leaders' Declaration on Forests and Land Use	Announced at the United Nations Climate Change Conference in Glasgow (COP26 in 2021), 134 countries pledged to halt and reverse forest loss and land degradation by 2030.
Deforestation	Loss of natural forest as a result of: i) conversion to agriculture or other non-forest land use; ii) conversion to a tree plantation; or iii) severe and sustained degradation.
EU-Mercosur Trade Agreement	Bilateral treatment between the EU and Mercosur (Argentina, Brazil, Paraguay, Uruguay) which should facilitate mutual trade.
European Green Deal	New growth strategy of the EU presented in 2019, with the overarching objective of reducing net greenhouse gas emissions in the European Union to zero by 2050.

Forest-risk commodities (FRC)	Commodities such as palm oil, rubber, soy, beef, co- coa and leather which are significantly linked to global deforestation.
Free Trade Agreement (FTA)	Agreement which reduces barriers to imports and exports between two or more countries by eliminating all or most tariffs, quotas, subsidies and prohibitions.
Habitat	The natural environment in which a species or group of species lives.
Illegal deforestation	Deforestation taking place against the laws and regulations of the country of harvest.
Nationally Determined Contributions (NDCs)	A concept that commits countries to reducing green-house gas emissions and adapting to climate change.  Parties are required to submit a NDCs every five years, take action to achieve the targets of this contribution and report on it regularly.
New York Declaration on Forests (NYDF)	Voluntary and non-binding international declaration endorsed in 2014 to take action to halt global deforestation aimed at halting global deforestation by 2030.
Paris Climate Agreement	International treaty on climate change adopted in 2015 that aims to reduce climate change by limiting global warming to well below 2°C and pursuing efforts to limit it to 1.5°C.
Sustainable Development Goals (SDGs)	Political objectives adopted by the United Nations (UN) in 2015 to ensure sustainable development at the economic, social and ecological levels worldwide.
Zero deforestation	No forest areas are cleared or converted at all.
Zero net deforestation	Allows the clearance or conversion of forests when this is compensated by an equal area that is replanted elsewhere.

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