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Thought Leadership Whitepaper

EU Sustainability Regulations:

How the EUDR and other Sustainability Regulations will impact consumer markets

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Overview

- The latest round of EU sustainability regulation is an attempt by the EU to influence global regulatory policy and value-chain practices in an effort to 'reduce net greenhouse gas emissions by 55% compared to 1990s levels by 2030', and to achieve 'no net emissions of greenhouse gases by 2050'.
- It could be argued that the EU aims to use the 'Brussels effect' to direct global policy on sustainability. This is the idea that the global landscape responds to the EU 'externalizing' its laws.
- The key regulation being brought in this year is the EU Deforestation Regulation (EUDR), the rules of which (and other regulations) will be enforced by the new Corporate Sustainability Due Diligence Directive (CSDDD).
- From 2026, generic claims relating to sustainability will effectively be banned under the Green Claims Directive. This Directive is intended to empower consumers by making them better informed by banning sustainability messages that are not backed up by evidence. Products in the plant-based meat and dairy alternatives sector will be among the most impacted, as sustainability messages are key consumer benefits for these products.
- The New Circular Economy Action Plan is described by the EU as one of the 'building blocks' of the European Green Deal. The EU wants more products to be repairable, reusable, and recyclable. This action plan revolves around the notion of circularity.
- The European Investment Bank predicts that the EUs various climate actions could result in a potential hit to EU-wide GDP of -0.4% by 2030, taking into account all of the EUs sustainability initiatives, but says the costs of not acting would be greater. The rationale behind such a relatively small hit to GDP is the belief that jobs lost through climate action will be replaced with jobs in sectors that will grow as a result of this same action.
- GlobalData Agribusiness consultants estimate that EUDR compliance premiums for companies operating in the supply chain for oil palm products and their derivatives - crude palm oil (CPO) and palm kernel oil (PKO) - and rubber could be in excess of US$1.5 billion on these two commodities alone. A good proportion of these US$1.5 billion premiums is likely to be passed onto EU consumers in the form of food and product price increases.
- EU companies importing EUDR-compliant oil palm products and their derivatives could face premiums of between $300-$600 per ton for palm kernel oil and $50-$100 per ton for palm oil, according to confidential industry sources.
- EU companies importing cocoa beans that are EUDR-compliant could face premiums from their suppliers of around $20-$30 per ton, according to confidential industry sources.

Executive Summary: Take-Outs

EUDR

- The EUDR will come into force from December 2024 to June 2025, and goes much further than previous regulation on this issue by outright banning materials linked to deforestation and applying to the entire value chain.
- The EUDR covers products made or derived from cattle, cocoa, coffee, oil palm, rubber, soya and wood if they are sold in the EU. The regulation must be followed by any company involved in the value chain of these commodities at any point, whether inside the EU or not.
- Under this regulation, companies must prove that none of their product's components, ingredients, or production processes have contributed to deforestation. The onus will be on companies to prove that not only their product, but their product's value chain is deforestation-free.
- The risk levels of deforestation designated by the EU to countries which supply EUDR-covered products will be of huge importance. EU companies currently sourcing from one country may switch to another if it is deemed lower-risk, as this lowers the risk of penalization from the EU, as well as the number of administrative checks for all of the companies involved in the value chain.
- European consumers could experience some degree of 'greenflation' as the extra premiums companies incur in complying with the EUDR regulations from additional administration and business disruption costs could be passed onto the consumer. Food and drink categories likely to be most affected include coffee, chocolate, soy-based meat alternatives, and products containing palm oil, in addition to personal care products such as shampoo.
- The additional administration required by producers of coffee, cocoa, soya, and other products covered in the EUDR will add significant costs to smallholder farmers. Governments in 'producer countries' outside of the EU will likely have to step in to support them. This is already happening for Cocoa farmers in West Africa and Coffee farmers in South-East Asia.
- The EUDR will specifically impact agricultural practices in places like South America, sub-Saharan Africa, and South-East Asia as the industry looks to avoid its impact being classed as 'deforestation' by the EU. This will include more 'agroforestry'- planting crops amongst other plants and trees.
- There will likely be increased friction between EU states and producer countries due to ambiguity in EU laws stipulating EU member states will provide 'assistance' in helping producer countries get up to speed.
- The incoming legislation could result in 'leakage' from the EU to China, as producers in non-EU countries look to sell their products to a huge market with less emphasis on enforcing sustainability rules and regulations overseas.

Executive Summary: Take-Outs

EUDR Impact on Consumer and Foodservice Sectors

» Beef

All products derived from cattle will have to prove no links to deforestation. This will impact the price of beef products, which are already under pressure with policymakers in some countries discussing a tax on high-emission meat products.

» Chocolate & Confectionary

EU companies importing cocoa beans that are EUDR-compliant could face premiums from their suppliers of around $20-$30 per ton, according to confidential industry sources. Operational costs for cocoa suppliers will increase. These premiums would cover mapping and segregation costs, but not any remediation costs. It is highly likely that these costs will be at least partly passed onto the consumer in some form whether it be through price increases, or value engineering through reformulation or product size reduction.

» Soymilk

Most soy (75-80% of the world's soybean production) is already used to feed livestock, leaving the remaining supply limited. Expansion in the soymilk sector will become more difficult as demand grows for non-deforested land. This is exacerbated by the fact that soymilk is already losing out to other plant-based milk alternatives such as oat and rice milk.

» Coffee

Operational costs for coffee suppliers will increase and the risk of sanctions for importers will become real. Many coffee suppliers save money by sourcing from multiple growers. This will become more expensive under the EUDR as each one will require GPS-based tracking and traceability protocols.

» Plant-based Meat Alternatives (PBMA)

If the cost of soy increases due to the additional operational costs enforced by the EUDR, manufacturers may look to alternative protein sources such as peas (which are not covered by the EUDR). The PBMA category has been one of Europe's food success stories in recent years, however, with interest in the category already waning, further price increases caused by 'greenflation' could further dampen the category's outlook.

» Oil Palm Products

EU companies importing EUDR-compliant oil palm products and their derivatives could face premiums of between $300-$600 per ton for palm kernel oil and $50-$100 per ton for palm oil. There will likely be disruption to oil palm industries in Southeast Asia as governments take different approaches to addressing sustainability in palm kernel oil and palm oil production. Further 'segmentation' within farms will likely take place as they split their operations between EU- bound and non-EU-bound products.

» Rice, Nut, Grain, and Seed (RNGS) Drinks

Soymilk will likely lose further ground to oat and rice milk as measures affect soy specifically. Further price increases for soymilk products may push the category further into the premium segment. This will benefit adjacent categories such as oat, almond, and rice milk, which are already growing faster than soymilk.

Executive Summary: Take-Outs

Key policy agendas and regulation discussed in this paper

Broad Policy Agendas

European Green Deal
- No net emissions of greenhouse gases (GhG) by 2050
- Economic growth decoupled from resource use
- No person and no place left behind

Directive for Empowering Consumers for the Green Transition
- Focusses on making the consumer more informed about products, production processes, and claims
- Tackles misleading claims, built-in obsolescence (products designed to break), and 'greenwashing'

Circular Economy Action Plan
- Focuses on 'decoupling economic growth from resource use'
- Stated aims of 'leading' the world towards a more circular economy
- Tackles sectors with high ecological impact such as electronics, construction, and food

Specific Regulation

EU Deforestation Regulation (EUDR)
- Comes into full force from 30 December 2024
- Affects these 'relevant commodities': coffee, cocoa, oil palm, soya, cattle, rubber, and wood
- Includes derivatives of these commodities
- Demands GPS tracking and an unprecedented level of traceability and transparency
- Affects EU and non-EU companies (who supply EU companies or non-EU companies) which sell in the EU
- Fines and confiscation are possible if rules not met
- Categorises countries into low, medium, and high risk of deforestation

Green Claims Directive
- Focusses on marketing and advertising
- Set to ban all generic claims such as 'good for planet' etc.
- Will require brands to back up any claim and prevent claims being made before evidence is provided to substantiate them
- Will impact what brands can say on promotional materials, packaging, and advertising

Reporting and Enforcement

Corporate Sustainability Reporting Directive (CSRD)
- Came into force in January 2023
- Can be viewed as the precursor to the CSDDD which comes into force in January 2027
- It solidified and strengthened existing laws on sustainability reporting
- Focuses on making sure information on sustainability is being reported

Corporate Sustainability Due Diligence Directive (CSDDD)
- Comes into effect in stages, starting in January 2027
- Essentially acts as the enforcing legislation for regulations like the EUDR
- Puts more responsibility on companies trading in the EU to assess the sustainability practices of their client companies outside of the EU
- Requires companies in breach of EU sustainability laws to take 'remedial action'
- Penalties for breaches which companies fail to remedy will be a maximum of 5% of worldwide annual turnover

Introduction to EU Sustainability Regulation

Introduction to EU Sustainability Regulation

Outlining the Key Foundational Policy Initiatives.

Understanding the basics

EU regulation can be notoriously complex and multi-layered, with many different pieces of legislation passed each year, many of which relate to and affect one another. To understand the basics of current and future EU sustainability regulation, it helps to first have an idea of the overarching longer-term visions and priorities of the EU Commission and associated regulatory authorities.

In addition to the more limited and specific laws it passes, the EU also has what it calls 'priorities,' 'agendas,' and 'action plans' that, for the sake of ease, can be grouped as 'policy initiatives.' These are broader, longer-term, and generally more vague than the corresponding pieces of legislation it passes to achieve them. In terms of sustainability, there are three key pieces of legislation of this type that are particularly relevant here.

The European Green Deal.

This overarching policy initiative drives and shapes much of the current and future sustainability regulation across the continent. Its top-stated aim is for Europe to become the first climate-neutral continent. Other stated aims include: 'no net emissions of greenhouse gasses by 2050', and 'economic growth decoupled from resource use'.

The Directive for Empowering Consumers for the Green Transition.

This is the consumer rights-focused aspect of the EU's strategy. It focuses less on industrial strategy and more on consumer protection and transparency. Contained within this directive are laws that will soon ban the use of generic sustainability phrases on product packaging and marketing, such as 'green,' 'eco-friendly,' 'responsible', and so on. It will also put greater pressure on manufacturers to make products repairable and inform consumers of the extent to which a product can be repaired or reused.

The European Circular Economy Action Plan.

This policy initiative targets manufacturers and places responsibility on them to increase the extent to which all parts of the supply chain, particularly the end products, minimize waste and 'incorporate circularity'.

Introduction to EU Sustainability Regulation

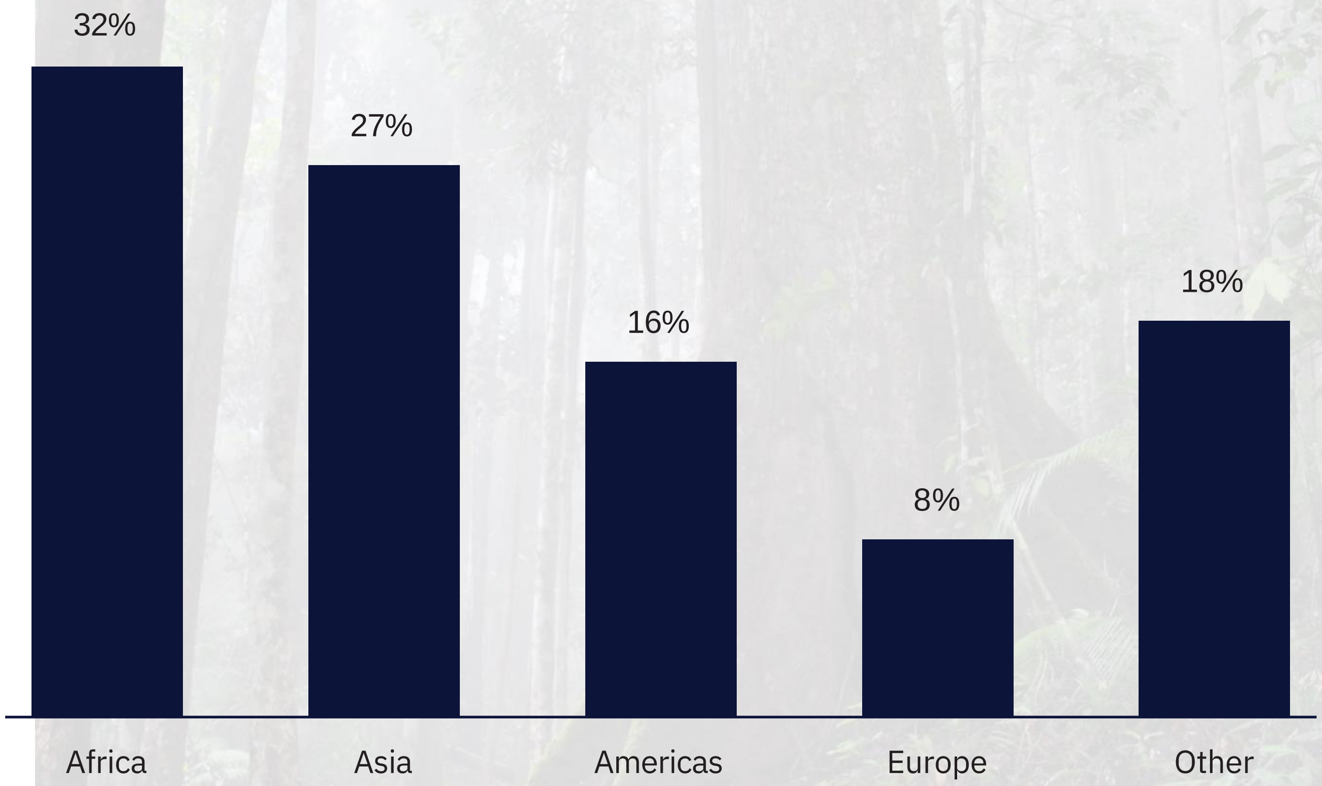
The Notion of Circularity.

Circularity

The notion of ‘circularity’ in the economy is not a new idea but has been gaining traction in recent years. It is also referred to as ‘donut economics’ and seeks to boost reusability, minimize waste, and foster sustainability in both a business and environmental sense. However, it does raise some concerns around growth, with heightened efficiency potentially leading to fewer economic transactions. The EU has addressed this in its impact assessments, which will be discussed later in this paper.

The EU hopes to influence global action on climate change in accordance with the 2015 Paris Agreement. The EU states in multiple public documents that it hopes to ‘set an example’ in climate action[1]. The EU Commission, in a resource titled ‘Delivering the European Green Deal’ states that the EU, the European Investment Bank, and EU member states are together the ‘biggest contributor of public climate finance to developing economies’[1]. The EU has a focus on shaping economic developments outside its borders, and so has passed legislation that has a direct impact beyond the EU-27, the European Economic Area, and the continent of Europe.

Geographical distribution of EU climate finance[1]



Source: [1] EU Commission- Delivering the European Green Deal; EU Commission- The European Green Deal; EU Commission- Completion of key ‘Fit for 55’ legislation

Note: Percentages in chart total 101% due to rounding

Introduction to EU Sustainability Regulation

The European Green Deal, Consumer Empowerment, and Circular Economies.

The European Green Deal

The European Green Deal fits in with popular political movements in the EU, UK, US, and worldwide. In the US, it is termed the 'Green New Deal' after Roosevelt's 'New Deal' package. Terms like 'Green Industrial Revolution' and 'Green Transition' are also used in similar contexts. Essentially, it is an industrial strategy, potentially the most significant and most drastic since the post-war era for many countries. This is the EU's version, with aims to be achieved, as with most climate policies, by 2050.

The aims of the European Green Deal[1]:

- **No net emissions of greenhouse gases (GhG) by 2050**
- **Economic growth decoupled from resource use**
- **No person and no place left behind**

This policy initiative covers a wide range of sectors, and much of the legislation encompassed by this plan relates to sectors such as energy and automotive. The initiative's most relevant parts to this paper include the Directive for Empowering Consumers for the Green Transition, which focuses on goods.

Directive for Empowering Consumers for the Green Transition

This directive entered into force in March 2024. The directive states that for the green transition to happen, consumers must make 'informed purchasing decisions' that 'contribute to more sustainable consumption patterns'[2]. In practice, this means putting further rules on manufacturers and retailers regarding product claims. Generic phrases relating to sustainability, such as 'good for the planet,' 'green,' 'eco-friendly,' and so on, will be banned from this year onwards, with claims now needing to be backed up by evidence.

Claims must align with the requirements of the accompanying Green Claims Directive, which sets out the rules for making sustainability claims. The main takeaway from this directive is that claims must be backed up by a recognised standards/accreditation authority (such as Rainforest Alliance) or government.

This directive will also affect claims and statements omitted from packaging and advertising, as there is scope in the Green Claims Directive for products to be found misleading through omission.

The New Circular Economy Action Plan

Adopted in March 2020, this action plan is described by the EU as one of the 'building blocks' of the European Green Deal.

Key aims

The EU wants more products to be repairable, reusable, and recyclable[3]. The key aim of this action plan revolves around the notion of circularity. This goes in tandem with initiatives aimed at improving consumer protection laws.

Key objectives

- Make sustainable products the norm in the EU
- Empower consumers and public buyers
- Focus on sectors that use the most resources and where the potential for circularity is high such as electronics and ICT, batteries and vehicles, packaging, plastics, textiles, construction, food, water, and nutrients
- Ensure less waste
- Lead global efforts on the circular economy

Source: [1] EU Commission- The European Green Deal; [2] EUR-Lex- Directive – EU – 2024/825; [3] EU Commission- Circular Economy Action Plan

Outlining Key EU Sustainability Regulation Discussed in this Paper

EU Deforestation Regulation (EUDR)

Arguably one of the EU's most impactful and wide-reaching pieces of sustainability regulation, one that will be felt by the Food & Beverages industry and worldwide.

'Relevant commodities' covered by the EUDR

- Cattle (all parts of the cow)
- Cocoa
- Coffee
- Oil Palm
- Soya
- Rubber
- Wood

Link to a copy of the EUDR

[REGULATION (EU) 2023/1115 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 31 May 2023]

The EUDR became law in July 2023 but will come into full force from December 2024 to June 2025. This is because, though companies must technically have started to follow the law from July 2023, large corporations were given 18 months to fully comply, and SMEs 24 months, taking the deadlines to December 2024 and June 2025[1]. Whereas previous regulation on this issue has mainly featured targets, quotas, and 'guidelines,' the EUDR goes much further, outright banning materials linked to deforestation and applying to the entire value chain.

This has the potential to be one of the most impactful pieces of sustainability regulation from the EU. Under the EUDR, companies must prove that none of their product's components, ingredients, or production processes have contributed to deforestation. The onus will be on companies to prove that not only their product, but their product's value chain is deforestation-free.

This applies to any company or trader who places products in the EU market or exports products from the EU market. It stipulates that they must prove the products do not contain anything from recently deforested land.

The EUDR defines 'recently deforested land' as land that has been 'deforested or degraded' after 31 December 2020.

How can companies provide the relevant proof?

The EUDR dictates that determining whether a material is 'deforestation-free' will depend on the country of origin's own laws and definitions around deforestation. While some countries are lax when enforcing their own deforestation laws, the EU will need proof that they have been met in full.

What will companies have to do?

To enter the EU, the product must be:

1) Traceable

Companies placing relevant products in the EU must provide information on the following:

GPS information on suppliers, buyers, and land plots. This must be submitted as part of a Due Diligence statement part of the Corporate Sustainability Due Diligence Directive (CSDDD).

2) Deforestation free

The product must not contain materials/ingredients from land deforested since December 2020.

Once operating in the EU, companies must complete due diligence paperwork consisting of three key steps:

1) Collect evidence to demonstrate that the product is traceable, deforestation-free, and fully legal based on the country's laws.
2) Conduct a risk assessment for possible non-compliance in the supply chain.
3) Take action to mitigate risks where they are identified.

Source: European Forest Institute- EUDR; Forest Stewardship Council- EUDR & FSC; [1] EUR-Lex (2024) Directive (EU) 2024/825

EU Deforestation Regulation (EUDR)

The EU will designate deforestation risk levels for countries. Those with higher risk levels will require additional checks.

Assessing Risk Levels by Country

Under the EUDR, not all countries will be treated equally. Though the rules come into force in December 2024, the European Commission will start ‘benchmarking’ countries based on risk level. This relates to new rules regarding ‘due diligence’ checks on sourcing and supply chains for companies.

Companies using materials from third countries must show they are not only following the EUDR but taking ‘remedial action’ if standards are not met.

The EU Commission will assess the risk levels of deforestation in each non-EU country and base the stringency of the due diligence checks on that. Countries deemed to be low-risk will have a simplified procedure. These ongoing assessments will likely require further revision over the coming years.

Implications for Food & Beverage Companies

The implications for countries receiving deforestation risk levels could be significant. Low-risk countries will become more desirable for food and beverage companies to trade with because less paperwork is required, and there is less risk of having to take remedial action for breaches of the rules. Companies looking to keep things streamlined may, therefore, avoid countries with high risks of deforestation.

For example, a large FMCG company might currently source its cocoa from Ghana, but if Ecuador were to be assessed at a lower risk level, there would be an incentive for the company to switch to provide certainty for its business operations and avoid the potential costs of remedial action.

Non-Compliance

The EUDR outlines several measures to be taken in the case of non-compliance. This can result in fines totalling 4% of the company’s annual turnover within the EU. Companies also face the prospect of product and/or income being confiscated.

Companies facing non-compliance measures will have the details of the incidents published on the EU Commission website, which could result in further reputational damage. If they were found to be in breach of the EUDR, this could be particularly damaging to companies that promote themselves on ‘green’ values.

Key take-outs

- The EUDR will come into effect at the end of this year for large companies, and mid 2025 for small and medium sized businesses.
- The materials/products impacted form a major part of global value chains and affect many sectors and product categories
- Companies will need to provide proof they have met both EU laws and the national laws of supplier countries.
- Additional costs will be felt across the board, but countries designated with higher risk levels of deforestation will likely bear more expense in the form of increased administration costs with the possibility that some companies could move their business to countries with a lower risk of deforestation.

Source: European Forest Institute- The EU Sustainable Cocoa Programme in Cote d’Ivoire; Forest Stewardship Council- EUDR & FSC

Green Claims Directive

Technically falling under the European Green Deal, the Green Claims Directive aims to crack down on misleading sustainability claims and 'greenwashing'.

The EU has covered all bases on green claims

Under the **Green Claims Directive (GCD),** set to come into force sometime in 2026, products must meet several requirements including[1]:

- Specifying if the claim concerns the whole product or just part of it.
- Base claims on widely recognised scientific evidence.
- Demonstrate the claim is not simply a requirement of law.
- Provide information on whether the subject of the claim performs significantly better than in common practice.
- Check that a positive achievement has no harmful impacts on climate change, resource consumption, circularity, sustainable use of water and marine resources, pollution, biodiversity, animal welfare and ecosystems.
- Provide primary information collected by the company.

These rules will also apply to non-EU companies whose products are marketed in the EU.

The only companies these rules will not apply to are micro enterprises - companies with less than ten employees and/or an annual turnover of less than €2M[1].

The GCD will crack down on partial truths and lying by omission

Companies used to be able to claim a '100% recyclable bottle' while the lid and label are not. Under this directive, brands will have to clarify specifically what is recycled.

Enforcement

This directive has not yet been finalized, but in its present form, it will be up to EU member states to enforce the directive and penalize noncompliance.

Green claims put to the test by the Green Claims Directive

- Good for planet
- Eco-Friendly
- Responsible
- Lower emissions
- Natural
- Kind to nature

Source: [1] European Parliament- Briefing, 'Green claims' directive: Protecting consumers from greenwashing

Corporate Sustainability Reporting Directive (CSRD)

The CSRD is already in place but contains multiple stages set to come into force over the coming years. The subsequent due diligence directive (CSDDD) strengthens the CSRD's requirements and introduces measures for non-compliance.

Corporate Sustainability Reporting Directive

Announced Q2 2021, now in force (since Jan 2023)

The Corporate Sustainability Reporting Directive (CSRD)[1] sets out the type of information that companies need to report on regarding sustainability. It is aimed at giving consumers, legislators, and other stakeholders a clearer picture of a company's 'non-financial performance'.

In addition to building on and strengthening existing corporate reporting laws, it is the first time the EU Commission has clearly defined a standardized framework for reporting non-financial information.

The CSRD is replacing the Non-Financial Reporting Directive (NFRD). More than four times as many companies will report sustainability information under the CSRD compared to the NFRD. The key difference, aside from the scope of companies, is that the CSRD will have an impact beyond the borders of the EU.

EU Reporting Timelines

Q1 2025: First reports for 2024 FY by companies already reporting under the NFRD and large non-EU undertakings, or non-EU parent undertakings of large groups with more than 500 employees and listed on an EU-regulated market, with mandatory limited assurance.

Q1 2026: First reports for 2025 FY by large EU companies not in scope of the NFRD and all large non-EU companies listed on an EU-regulated market that are not covered above.

Q1 2027: First reports for 2026 FY by listed SMEs (See APPX for Definitions), small and non-complex credit institutions, and *captive insurance undertakings.

Q1 2028: Mandatory limited assurance might become reasonable assurance. This broadly means that regulators will require less evidence.

Q1 2029: First reports for 2028 FY by third-country parent companies with net turnover for the past two years above €150M in the EU, either at group or individual level, where there is a large EU subsidiary or where there is no large EU or EU-listed subsidiary, branches with more than €40M net turnover of the non-EU ultimate parent will need to publish and make accessible a sustainability report at the group level of the non-EU ultimate parent.

Source: [1] EUR-Lex- Directive (EU) 2022/2464; European Commission- Corporate Sustainability Reporting

* Captive insurance undertakings: a subsidiary created by a company to provide insurance to its parent company.

Corporate Sustainability Due Diligence Directive (CSDDD)

This regulation underwent some last-minute changes in the first half of 2024, somewhat dampening its initial impact. However, the directive is still set to have far-reaching implications for traders worldwide.

Corporate Sustainability Due Diligence Directive

The Corporate Sustainability Due Diligence Directive (CSDDD) was originally going to affect EU companies with a global net turnover above €150M and large non-EU companies with EU-wide revenue above €300M, as reported by the EU Commission in December 2023. However, the final version passed in April 2024 revised those numbers upwards. The CSDDD now states that the rules apply to companies with 1,000 employees and a turnover of €450M[1].

The final version also elongated the implementation period for companies of different sizes, as follows:

2027: Companies with 5,000 employees and €1.5B turnover

2028: companies with 3,000 employees and €900M turnover

2029: Companies with 1,000 employees and a €450M turnover

Whereas previous legislation required that they report on environmental and human rights, the CSDDD requires that they do 'due diligence' across their operations.

Defining 'due diligence'

In practice, this means companies must show adherence to the human rights and environmental protections set out in EU legislation.

Companies will be required to show that both their own and their supplier's operations adhere to the laws. They must show what remedial action they are taking to address any issues. Companies will have to develop 'preventative action plans' and get their direct business partners to agree to comply with them contractually. This is where business potentially becomes more difficult for EU companies when negotiating with their third-country supply partners.

The CSDDD aims to link with other existing rules

The CSDDD will help enforce and protect the EU's European Green Deal legislation. However, its scope doesn't end there, as it also aligns with other existing international rules, including those set out by the United Nations and the OECD.

Source: World Economic Forum-EU governments back human rights and environmental due diligence law for supply chains; [1] EU Commission- Press Release - Corporate sustainability due diligence: Council and Parliament strike deal to protect environment and human rights; Forbes- After Delays, EU Approves Corporate Sustainability Due Diligence Law

Impact of EU Sustainability Regulation

The Macroeconomic Outlook

The EU's impact assessments discuss the hit to GDP as a potential small decrease, claiming that most of the impact will be on the composition of GDP, as opposed to the total aggregate value.

The hit to EU GDP

There is much debate amongst economists and policymakers regarding the actual effect of all this sustainability regulation on the economy. When discussing the economic 'impact' of something, GDP is usually the main focus. The EU's own research into sentiment across the EU, through the European Investment Bank, has found that 56% of Europeans believe climate change policies are a source of economic growth[2].

The EU has researched the potential effects of the Green Transition on EU GDP growth. It argues that the impact will be more on the make-up of GDP as opposed to the aggregate value of it.

The European Parliamentary Research Service, in a briefing to the European Parliament, posits that assuming the target of reducing GhG emissions by 55% by 2030 (compared to 1990s levels), the 'worst-case scenario' will see aggregate GDP' 0.4% below the baseline.' The rationale behind such a relatively small hit to GDP is the belief that jobs lost through climate action will be replaced with jobs in sectors that will grow as a result of this same action. For example, jobs lost in the fossil fuel industry will be replaced by jobs in the renewable energy industry[1].

The impact on corporations

EU-based companies will of course be the most impacted by any EU sustainability regulations, but the impact will be felt far and wide. Non-European companies that sell into the EU market or supply companies that sell into the EU market will likely face increased operational costs as a result of regulations such as the EUDR and CSDDD.

Businesses supplying EU companies must provide those companies with additional paperwork certifying the traceability of the materials/products supplied. This will add to labor costs and could even slow the rate at which deals are made. Put simply, the EU companies will need to demand more work from their non-EU suppliers, and the suppliers will face the prospect of EU customers becoming more challenging to do business with as they navigate the additional rules and regulations. This could even lead to a slowdown in company growth for businesses that are late in aligning themselves with the EU rules. Another possibility is that trade is lost to other major economic blocs such as China, as non-EU companies look to sell to markets with less oversight.

The impact on the developing world

The EUDR is an example of the EU attempting to lead other nations and trade blocs on the issues of sustainability, climate change, and the 'green transition.' However, for many countries in what is termed the 'global south,' the potential impact on their economies is judged to be too severe.

17 countries, including South American nations such as Brazil, Colombia, and Guatemala; African countries such as Ghana and Côte d'Ivoire (Ivory Coast); and Southeast Asian countries such as Malaysia, Indonesia, and Thailand, have expressed their opposition to the EUDR. The main issue raised by these countries is the lack of dialogue with the EU, highlighting the need for more inclusive and collaborative policy-making.

"The legislation is unilateral, as it was created without an effective dialogue with producer countries and without being supported by any agreement negotiated at international level"[3]

Pedro Miguel da Costa e Silva, Brazil's Ambassador to the EU
(Reported in Euronews August 2023)

Source: [1] EU Parliament- The Economic Impact of the Green Transition; [2] European Investment Bank- The Economic and Social Impact of the Green Transition; [3] Euronews- Why the global South is against the EU Deforestation Regulation

The Macroeconomic Outlook

Although the rules will apply to both EU and non-EU countries selling in the internal market, some producer countries have expressed dissatisfaction with the perceived lack of consultation.

Some of the arguments made by supplier countries such as Brazil and Indonesia revolve around the idea that the EU is acting in a discriminatory manner[1]. There are concerns that the Classification system which sorts countries into low, standard, and high risk for deforestation, is too arbitrary, and too top-down. It allows the EU to make doing business with Europe much more accessible for certain countries over others.

While the EU Commission maintains that these rules are fair since they apply to EU countries as well, it is also true that the rules were passed with the consent of those countries and not the consent of non-EU countries.

Despite the complaints, these countries know the EU is extremely unlikely to roll back any of these laws now that they have been passed. For example, Côte d'Ivoire was one of the 17 signatories expressing disapproval of the EUDR. However, the country's government began distributing electronic tracking cards to Cocoa farmers in February 2023 in preparation for the new laws.

There is reason to believe that some countries may see the EUDR as an opportunity, even those deemed 'high risk' by the EU. This is because the EUDR commits member states to provide 'financial assistance' to the 'least developed countries.'

This means that countries ranking low in terms of economic development, but who provide large quantities of goods to the EU, such as Côte d'Ivoire and Ghana, may find themselves in an advantageous position.

Key take-outs

- The EU predicts a relatively small hit to EU-wide aggregate GDP at 0.4% below the baseline, but the true effects will become clearer over the coming years.
- Countries in danger of being 'high risk' could seek assistance from EU member states in line with the EUDR's commitments.
- Developing countries with a near monopoly on certain EU imports, such as West African countries with Cocoa or SE Asian Countries with oil palm products and their derivatives such as palm oil, may be able to use their position to gain leverage over the EU, with the prospect of them seeking other markets.

Source: [1] Euronews- Why the global South is against the EU Deforestation Regulation

Cocoa Producing Countries

Cocoa producers could turn to agroforestry to strike a ‘balanced’ approach to cocoa tree expansion.

African Cocoa and European Chocolate

The impact of the EUDR and CSDDD on the chocolate and confectionary sector will be profound. The EUDR covers cocoa and all its derivatives, meaning any product containing chocolate - whether food, beverage, raw ingredients or anything else - will be subject to the deforestation regulation and forced to correct any missteps by the due diligence directive (CSDDD).

Though not a producer of cocoa itself, the EU is still a large chocolate manufacturer and an even larger chocolate consumer. Hence, these laws acknowledge Europe’s contribution to historic deforestation for the sake of agricultural expansion. The purpose of the EUDR is to make sure further expansion is done in a less destructive way than before. This could lead to existing cocoa plantations going up in demand, and subsequently value.

Ghana and Côte d'Ivoire will be the two countries most affected by the new regulation on cocoa, with the two African nations accounting for almost 60% of the world’s cocoa production.

How is the Cocoa industry responding to the EUDR?

Regarding cocoa producers, one response to the legislation is agroforestry. This is an integrated approach that combines agriculture and forestry and offers an alternative sustainable option for cocoa production. Essentially, agroforestry of this type means planting cocoa trees alongside other plants to create a more diverse ecosystem.

Cocoa is viewed fairly positively as a crop in terms of its impact on the environment, as it contributes to soil regeneration, so agroforestry is already commonplace in, for example, Colombia, where many small-scale farmers grow it alongside other plants already. Therefore, the transition to completely deforestation-free cocoa will have incentives beyond avoiding the EU regulators.

In terms of the chocolate brands themselves, aligning quickly with the new regulation is in their best interests, as it will minimize the likelihood of delays and costly remedial action.

Cocoa-producing countries: Thousand Tons[1]

Source: [1] Our World in Data- Cocoa Bean Production; UN FOA- SEPAL Forest and Land Monitoring for Climate Action; EU-Lex- 2019/1937

Cocoa Producing Countries: Business Responses

There is potential for smaller cocoa-producing nations, such as Colombia, to take some demand from the West African giants

Luker Chocolate: Colombia

Colombian B2B chocolate producer Luker Chocolate is embracing and incorporating the new EUDR regulation into their marketing and brand credentials. As a company selling chocolate ingredients and bespoke ready to launch chocolate products to large chocolate companies, Luker Chocolate has seen an opportunity to assist other businesses in meeting the new rules. The company achieved carbon neutrality in 2021 and aims to achieve ‘carbon neutrality with outside providers by the end of 2027.’

Companies like this will no doubt hope to leverage their position as being ahead of the competition on sustainability and serve a demand for client companies looking to improve their own brand’s sustainability credentials.

The company highlights that, in Colombia, ‘the expansion of cocoa crops is done under a controlled strategy supervised by national agencies to prevent deforestation.’

Therefore, the whole Colombian cocoa industry could stand to gain from the EUDR as brands look for distributors who are already virtually aligned with the new regulation.

Cocoa production in Colombia has already increased by 60% since 2014[2]. If its environmental agencies are already focused on preserving biodiversity and preventing deforestation, which appears to be the case, then the country could stand to take business away from major cocoa producers in Africa.

“We embrace the new regulations as we continue to shape a responsible and sustainable future for chocolate production.”

Julia Ocampo – VP of Sustainability & Cocoa Sourcing at Luker Chocolate[1]

LUKER Chocolate®

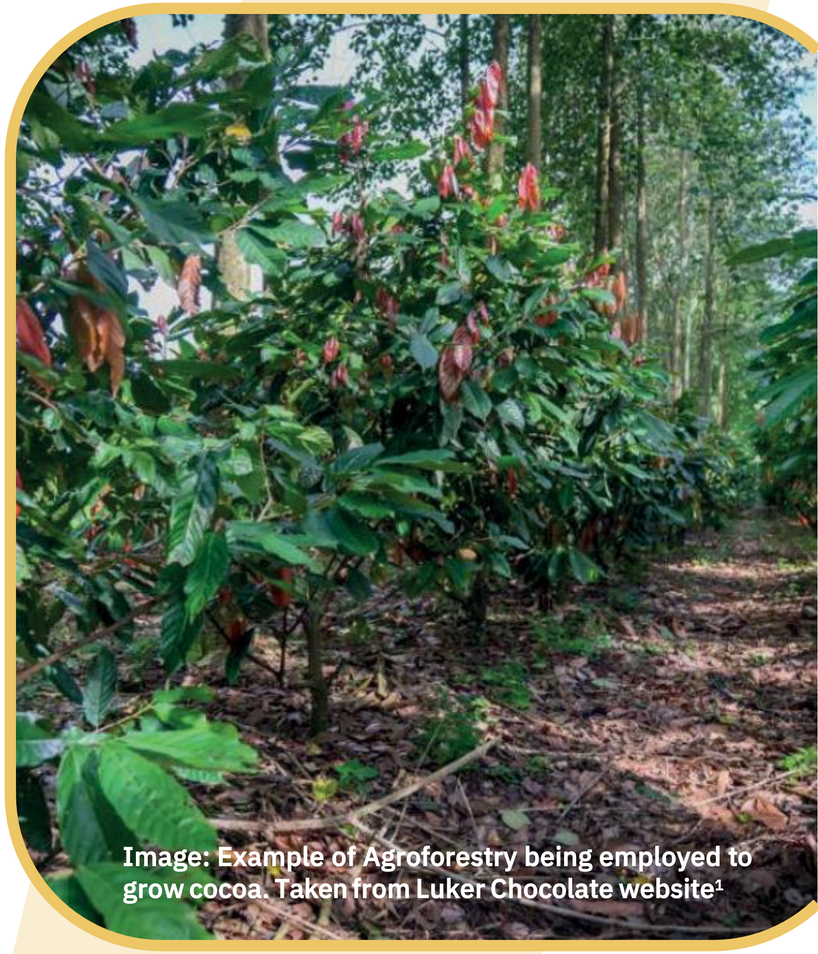


Image: Example of Agroforestry being employed to grow cocoa. Taken from Luker Chocolate website[1]

Source: [1] Luker Chocolate- UNDERSTANDING THE EU’S NEW REGULATION ON DEFORESTATION-FREE PRODUCTS- ;
[2] Confectionary News- with cocoa output in Colombia rising, farmers look for signs of economic progress as well as recognition

Cocoa Producing Countries: Business Responses

Some companies are investing in landscaping initiatives.

Landscape Approaches

Although many feared the EUDR would cause importing companies to move away from ‘high-risk’ regions and countries, this is not necessarily the case. As the EUDR covers not just deforestation but also requires companies to meet all the social and welfare requirements of the source country, some companies are investing in landscaping initiatives.

A landscape is a socio-ecological system that consists of natural and/or human modified ecosystems, and which is influenced by distinct ecological, historical, economic and socio-cultural processes and activities.

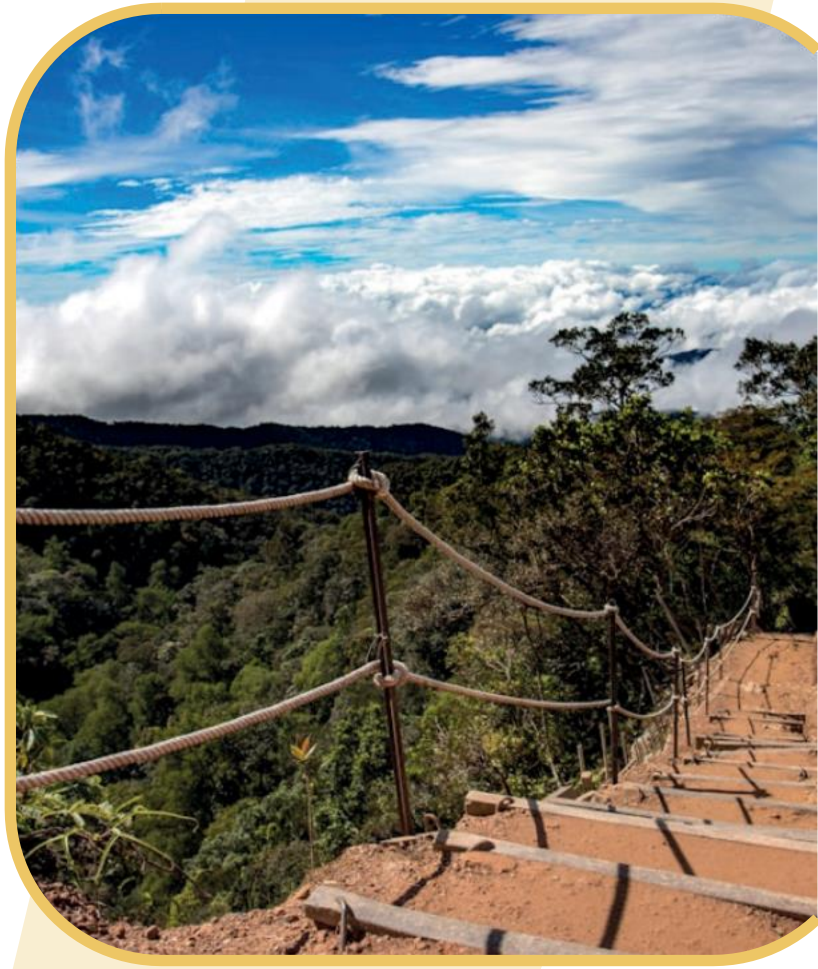
A “landscape approach” is a way of managing the landscape by long-term collaboration among multiple stakeholders, with the purpose of achieving sustainable landscapes. It involves convening key stakeholders to build consensus about landscape management... and collaborative initiatives in specific places that span multiple sectors and go beyond the scale of individual farms, forest management units, and protected areas.

WWF - World Wide Fund for Nature website[1]

While some companies may opt to avoid high-risk areas altogether, others are taking advantage of existing sustainability and environmental initiatives in the source countries of commodities like oil palm, cocoa, and coffee.

Dutch NGO, Sustainable Trade Initiative (known as IDH) reports evidence of landscape approaches reducing deforestation in Brazil. Its report points to the Brazillian Mato Grosso region, which adopted a landscape approach for eight years. It was the one region that did not see a jump in Amazon deforestation during the Bolsonaro government[2].

Landscaping has also seen success in Indonesia and Malaysia, two more countries that produce oil palm and cocoa. As these countries now have strict policies around deforestation, expansion is not easy to achieve. By partnering with governments and communities to adopt joined-up, holistic strategies that apply to a whole jurisdiction, smallholder suppliers can increase supply output without causing further deforestation.



Source: [1] WWF- Sustainable Landscapes; [2] IDH-Despite the EU deforestation regulation, companies are investing more in palm oil. Why?;

Consumer Brands: Green Claims

The upcoming ban on generic claims will likely impact vegan and 'plant-based' brands that currently leverage popular perceptions around plant-based food and sustainability.

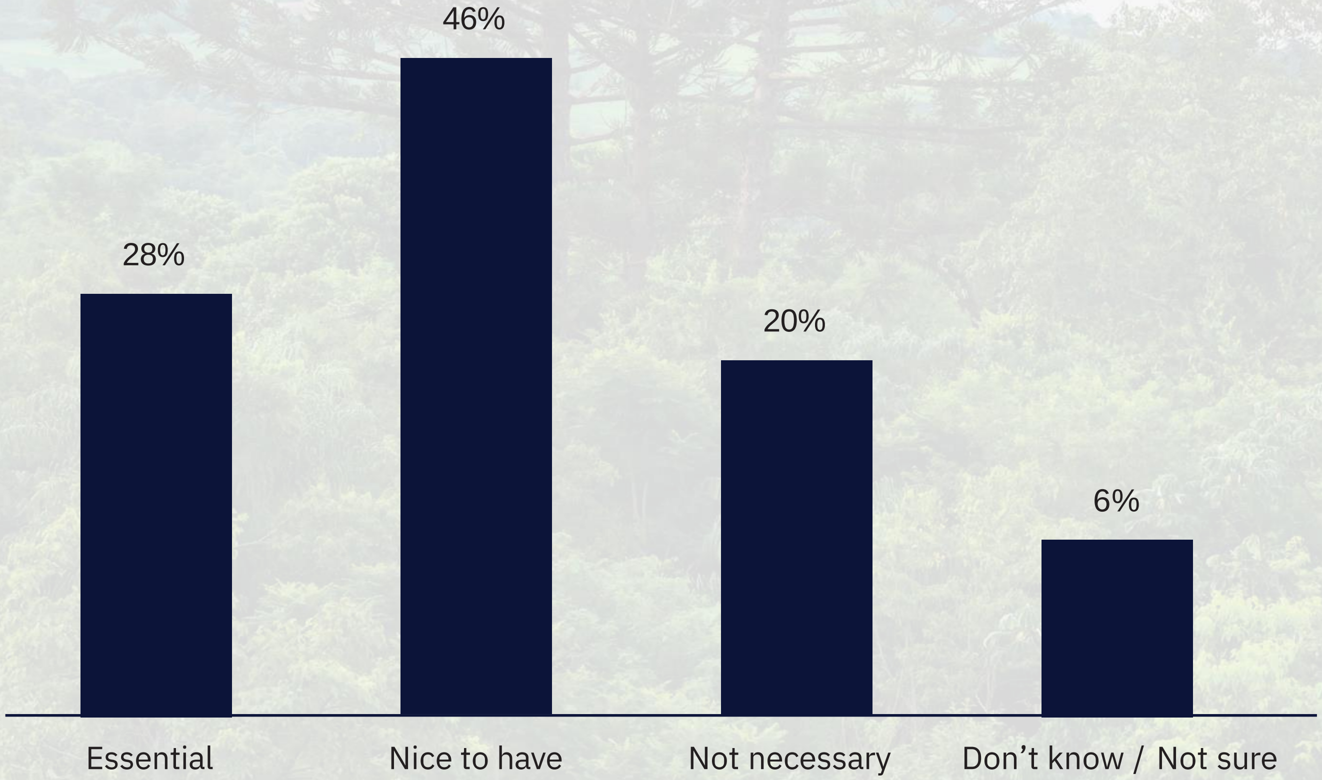
The impact of a ban on 'greenwashing'

The Green Claims directive means that from 2026 onwards, 'green' marketing claims not backed up by rigorous evidence will be banned. This will impact many brands that make sustainability central to their marketing.

According to the latest GlobalData consumer survey from Q1 2024, 74% of consumers globally view sustainability as an 'essential' or 'nice to have' feature when deciding to make a purchase. Among younger age groups, this figure is even higher. Only around one-fifth of the population views sustainability as unnecessary.

Brands already know the importance of sustainability, which is why it is featured in marketing and advertising across virtually all sectors. However, the incoming ban on sustainability messages not backed up by evidence will cause many brands to lose the ability to appeal to consumers on sustainability grounds.

Global: How important are each of the following features when deciding to make a purchase? - Sustainable/ Environmentally friendly



Source: GlobalData Consumer Survey Results 2024 Q1

Consumer Brands: Green Claims

The upcoming ban on generic claims will likely impact vegan and ‘plant-based’ brands that currently leverage popular perceptions around plant-based food and sustainability.

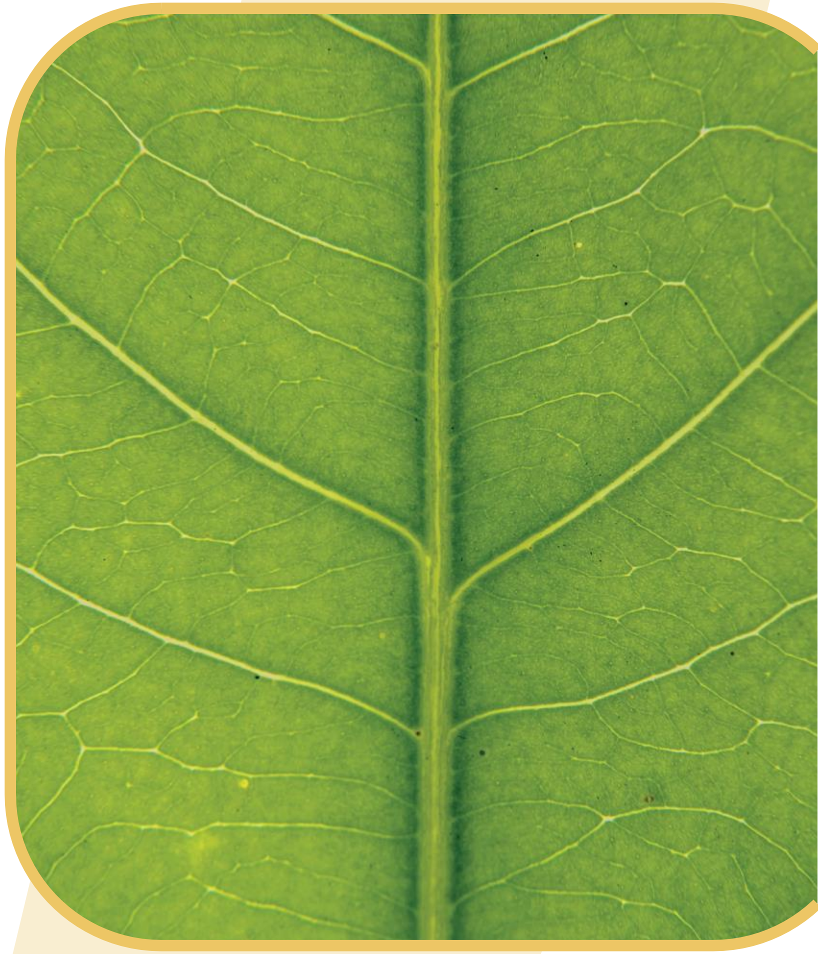
What type of brands will be most impacted?

A clear link exists between vegan products and perceptions of environmentalism and sustainability. Brands operating in the vegan and ‘plant-based’ space lean heavily into environmental messaging, which naturally contrasts with existing perceptions around meat and its contribution to global warming. However, these brands are leveraging consumer perception, not necessarily based in fact, to boost their own reputations. This is clever marketing, but it can lead to misinformation or false perceptions about just how sustainable something really is.

There is a strong argument that bans on phrases such as ‘better for the planet,’ ‘responsible,’ and ‘natural’ may result in the brands who are actually the best for the planet gaining share, as the range of products displaying such claims will inevitably narrow, leaving consumers seeking those claims with fewer options. This would also educate and inform the FMCG industry on how much sustainability claims matter when stripped from a well-loved brand or product.

Brands being penalized for ‘greenwashing’

Taking Oatly as an example, the company was instructed by the UK’s Advertising Standards Authority not to repeat some of its TV ads in the UK following over 100 separate complaints. The ads claimed Oatly oat milk generated ’73% less C02 than milk’, but these claims could not be adequately substantiated[1]. This case demonstrates that, currently, brands only get real scrutiny when enough people notice, which means the claims aren’t removed until consumers have already seen them. Under the Green Claims Directive, misleading claims like this won’t make it into public view in the first place.



Source: [1] BBC News- Oatly ads banned over ‘misleading’ environmental claims

Consumer Brands: Green Claims

The current market contains many products plastered with multiple vague claims about the environment.

The current green claims landscape

Many brands fill their websites, ads, and packaging space with vague claims implying ecological responsibility. Once the new EU laws take full effect in 2026, a number of these claims will no longer be options when selling within the EU.

Claims related to real accreditations, such as Rainforest Alliance, Fairtrade, and Forestry Stewardship Council, will be unaffected. However, while brands can continue showing these accreditations, they cannot make additional claims based on them unless they meet the EU criteria.

Examples of generic claims that will not be able to be made in the EU when the new law takes effect...

Yeo Valley's 'We always strive to put nature first'

Quorn's 'Less impact on our planet's resources'

Alpina's 'It's good for the planet'

Vilay's 'Committed to a sustainable world'

Claims:
- 'We always strive to put nature first'
- Organic
- Free-Range

Claims:
- 'Less impact on our planet's resources'
- 'Sustainable nutrition'
- Mycoprotein: a nutritious and sustainable protein source.
- Certified by the Carbon Trust

Claims:
- 'Committed to a sustainable world'
- Made in Colombia
- Forest Stewardship Council
- Lactose Free
- 'Regular visits to farmers focusing on improving milk quality, good land management, and animal care'

Claims:
- 'For the planet'
- 'For the animals'
- Plant-based

Key take-outs

- Generic product claims relating to sustainability will be effectively banned within the EU from 2026.
- This is intended to empower consumers by making them better informed.
- Sustainability messages will be banned that are not backed up by evidence.
- Products in the plant-based meat and dairy alternatives sector will be among the most impacted, as sustainability messaging is a key part of the marketing of these products.

Source: The Conversation- Social media ads are littered with 'green' claims. How are we supposed to know they're true?; Travers Smith- Green claims: prepare for tougher EU rules on promotion of products and services.

Consumer Brands: Consumer Goods Companies

A number of large corporations, including manufacturers, distributors, and retailers, have shown public support for anti-deforestation rules.

Large corporations welcome regulation

In May 2021, 11 companies including Tesco, Danone, METRO and Reckitt signed an open letter to the EU calling on it to 'increase supply chain transparency and traceability for commodities that may be linked to deforestation.

The letter states[1]:

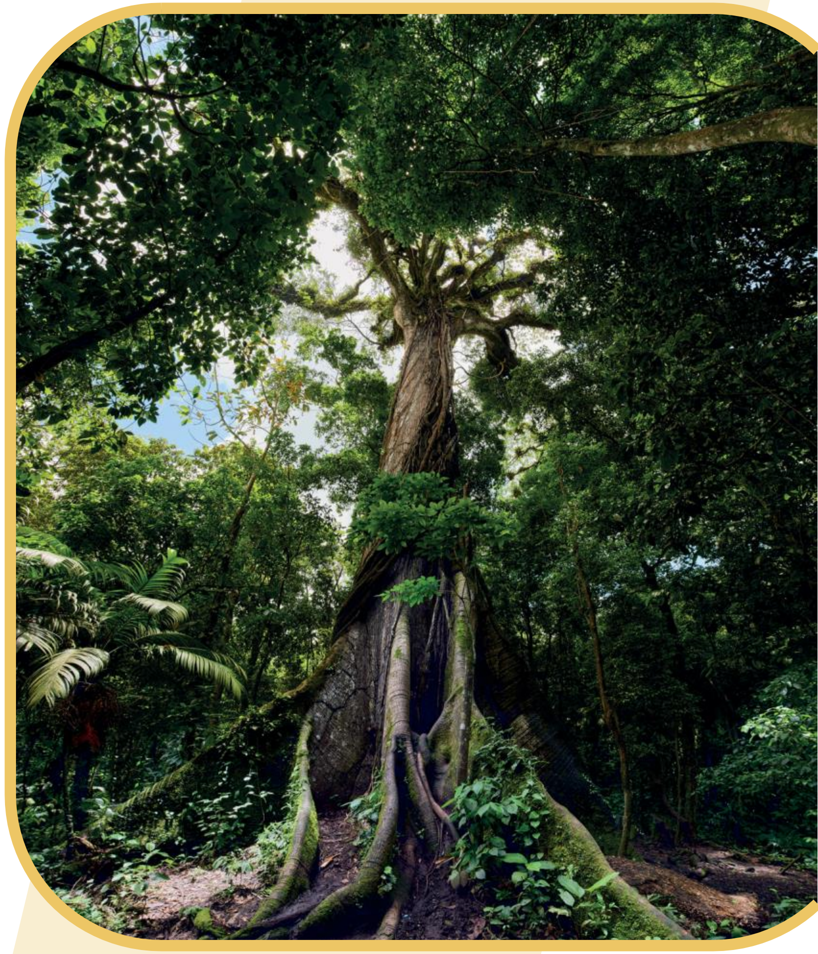
"...Business leaders support bold EU actions to eliminate imported deforestation... We are 11 businesses across the value chain – from suppliers to manufacturers and retailers – that request strong EU actions to eliminate imported deforestation, starting with traceability when entering the EU internal market..."

Why would companies welcome more paperwork?

While the letter details the need to protect the environment and create a fair global system, it also calls on the EU to 'strengthen cooperation with producing countries through technical assistance; exchange of information; trade and other incentives.'

Faced with the considerable task of ensuring each of their suppliers demonstrate compliance with the EUDR it is not unreasonable for these companies to seek to persuade the EU to play their part in helping to make 'producer countries' fit for the new regulation, thereby making it easier for their suppliers to comply.

The EUDR also stipulates that companies operating in the EU are responsible for ensuring their value chain is up to standard. However, it does mention the EU and its member states offering assistance as well. It is possible that this letter and the movement that produced it did influence policy.



Source: [1] Nestle- Nestlé supports ambitious EU action to address global deforestation; Reuters- Investors may exit consumer goods firms over EU deforestation law; Nestle- Deforestation-free supply chains

Consumer Brands: Consumer Goods Companies

Added costs to industry can have a disproportionate impact on smaller, independent businesses, as was observed in the global foodservice sector during the COVID-19 pandemic.

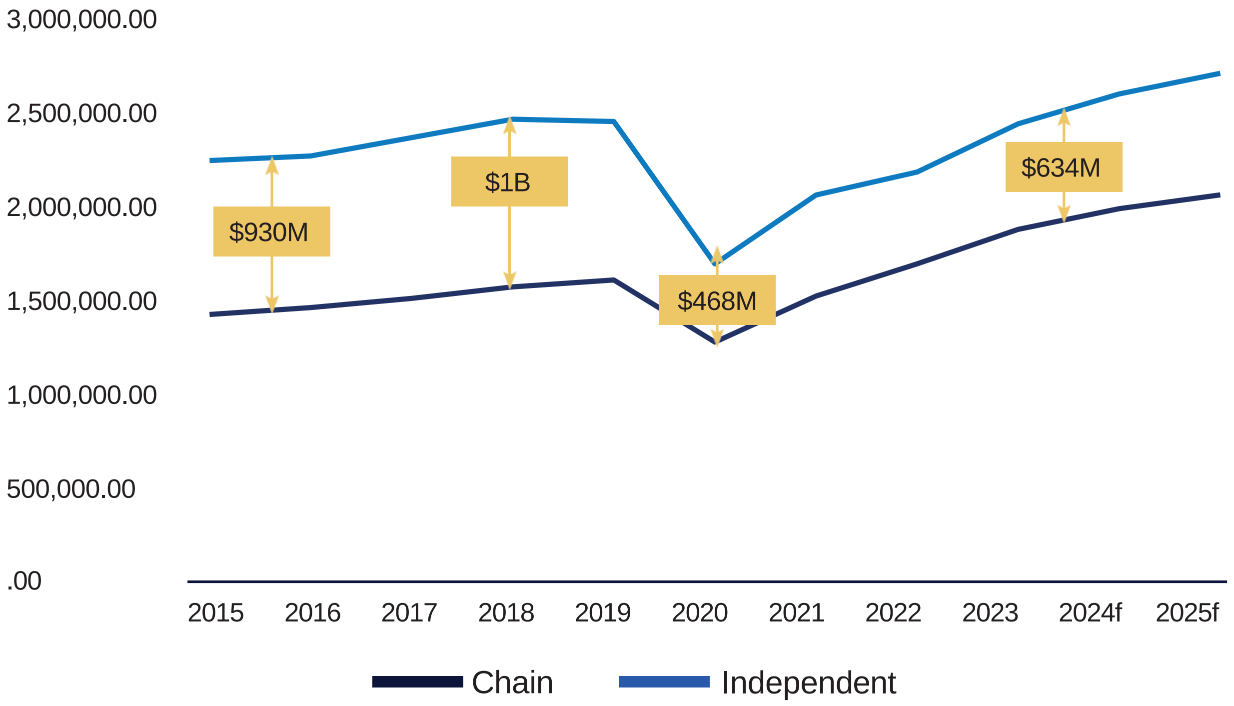
Is there an opportunity for large companies to solidify dominance?

The increased operation costs that companies will need to pay and are already starting to pay will disproportionately impact small businesses in the EU. This is because the investment required in tracking and traceability will make up a smaller portion of a large company's overall expenditure than smaller companies, even though large companies may use more suppliers.

Therefore, large companies may be welcoming of these policies on the basis that it will be good for them competitively, as competition from small businesses may get weaker if they have to increase prices to cope with the new administration requirements.

During the COVID-19 pandemic, GlobalData measured a narrowing gap between the revenue of total chain restaurants and the revenue of total independents, with independent's lead worldwide shrinking significantly from $1B in 2018 to $468m in 2020. This can be attributed to the fact that large foodservice companies could take on more debt than smaller ones, allowing them to endure the period of lost revenue more easily. The onset of EU sustainability regulation could have a similar effect on EU companies, with small importing businesses unable to cope with the rate of change, thereby ceding market share to the big players.

Global Profit Sector- Foodservice: Chains vs Independent Restaurants (Value M USD OSP), 2015 – 2025f



Source: GlobalData Market Analyzers- Foodservice Intelligence Center- Chains vs Independents

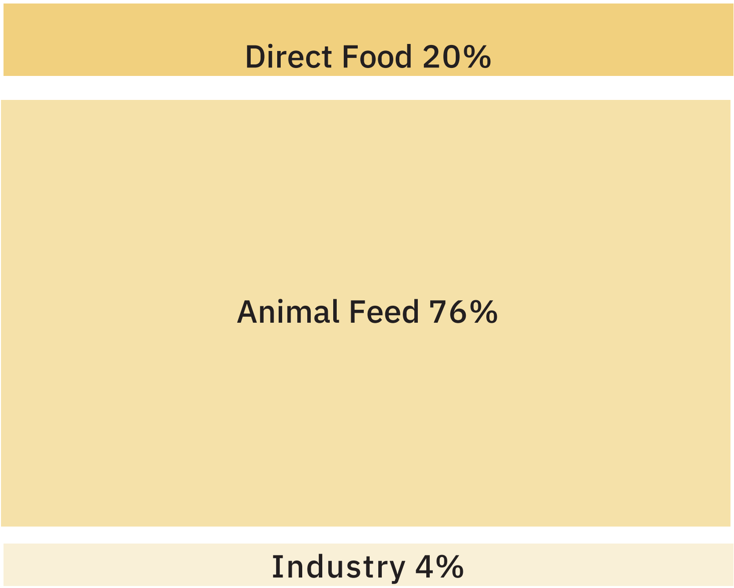
Plant-Based Meat Alternatives (PBMA)

Soya is a key ingredient in many PBMAs. If the EUDR pushes up costs for PBMA brands, it could lead to a wave of product reformulations, providing opportunities for producers of high-quality alternatives to soy protein.

Around 75-80% of the world's soybean production goes towards feeding livestock.

Of the roughly 20% that goes directly towards food for people, over half is used to produce oil[1].

Global Soy Production[2]



Brazil and the USA produce around 70%[2] of the world's soybeans. Soy is one of the products listed in the EUDR, as it has historically been linked with deforestation, particularly in South America.

Soy is a key ingredient in many plant-based meat alternative products. For example, it is the main protein ingredient in Impossible's plant-based 'beef' burger patties.

Increases in the cost of soy brought on by the additional operational costs enforced by the EUDR could lead to some brands changing their product formulation. For example, Impossible's main rival, Beyond Meat, uses peas as the core source of protein in its beef substitutes. Peas will not be affected by the EUDR and have a better record in terms of deforestation.

Key take-outs

- Large corporations may benefit from being able to shoulder the increased administrative costs while smaller manufacturers and sellers' struggle.
- The EUDR could cause a shift in demand from soy to other sources of plant protein by meat-substitute manufacturers.
- Pea protein will likely become more popular as it is less linked to deforestation and is already successfully used in PBMA products.

Source: [1] Our World in Data- Drivers of Deforestation; [2] USDA FOS- Production - Soybeans

Consumer Pricing: ‘Greenflation’

A new wave of EU rules will likely have a similar impact to recent economic shocks, such as the war in Ukraine and the supply-chain issues caused by China’s ‘Zero COVID’ policy.

How could this legislation lead to price increases?

The term ‘greenflation’ refers to the phenomenon of sustainability and climate change mitigation efforts that cause price increases. In the context of EU legislation, much of what has been discussed will add extra operational costs to producers outside the EU and companies inside the EU importing goods. There is precedent suggesting this additional cost will be passed onto the consumer.

If one views the onset of all this regulation as an exogenous shock—which it can be, particularly for non-EU countries, some of whom have voiced their opposition to these laws being ‘imposed’ on them—then it is reasonable to assume the extra costs incurred will be passed onto the end-user.

- When the war in Ukraine raised European energy prices, the costs were immediately passed on to the consumer, not just from energy companies but also from consumer goods companies whose manufacturing and transit costs had increased.
- When China’s Zero COVID policy caused supply chain chaos stemming from backlogs in major port cities and a shortage of shipping containers, FMCG and foodservice companies passed the costs onto the consumer.

If one views the onset of a new round of stricter-than-ever regulation from the EU through a similar lens, one can assume that some of the increased costs will be passed onto the consumer through price increases.

Products most at risk of ‘Greenflation’

The products most at risk will be the ones containing materials specified in the EUDR. In terms of the FMCG sector, these are the types of products likely to pass along extra costs:

Oils and Fats: On course for further price increases

The EUDR applies to oil palm products and their derivatives, which includes palm kernel oil as well as palm oil. Around 80%[1] of palm oil is used for human consumption, mostly in the form of margarines, food oil, and cooking oil. Another oil palm derivative, palm kernel oil (PKO), is mainly used to produce oleochemicals - these are chemicals that are widely used in personal care, cosmetics and household cleaning products - as well as other industrial uses. PKO is also used in specialty food applications, such as in chocolate confectionary.

The value chain of oil palm products and their derivatives is one of the more salient sustainability debates going on right now, with Southeast Asian countries already passing laws in an attempt to decouple the industry from deforestation. EUDR implementation will add ‘premiums’ to palm kernel oil as well as palm oil imports.

Confidential industry sources report that for palm kernel oil this could be as much as $300-$600 per ton, and even though the supply of EUDR-compliant palm oil is likely to be in-line with demand, a price premium of $50-$100 per ton is anticipated.

EUDR compliance could cost EU consumers up to US$1.5 billion on two commodities alone

GlobalData Agribusiness Consultants estimate that EUDR compliance premiums for companies operating in the supply chain for oil palm products and their derivatives - crude palm oil (CPO) and palm kernel oil (KPO) - and rubber could be in excess of US$1.5 billion alone.

Whilst companies operating in these supply chains will be able to absorb some EUDR compliance costs themselves a good proportion of this US$1.5 billion on cost is likely to be passed onto EU consumers in the form of food and product price increases.

The US$1.5 billion EUDR compliance premium figure is based on GlobalData’s understanding of current commodity pricing and the likely impact of increased costs of EUDR compliance on the supply chain of these commodities (see Appendix/Further Information).

However, we recognize that 'EUDR compliant commodity premiums are still being agreed confidentially between buyers and sellers, so some uncertainty remains over the final numbers.

Source: Science Direct- Forest Policy and Economics, Prospects and challenges for policy convergence between the EU and China to address imported deforestation. [1] Cirad- Our activities, our impact – Tropical value chains - Oil palm.

Consumer Pricing: ‘Greenflation’

Some examples of product categories that will likely be subject to greenflation after the onset of the EUDR

Ground coffee: Could cheap variants be under threat?

Premium, mid-tier and cheaper roast and ground coffee brands are mostly coffee blends sourced from multiple locations. However, with the onset of EUDR, the more locations a coffee brand sources its coffee from, the more work and expense it will have to undertake to carry out GPS-based tracking and tracing of the origins of the coffee it uses. These extra costs might be easier for premium and mid-tier brands to absorb or pass on to consumers in price increases than cheaper brands could. This extra financial burden on cheaper brands could cause low-tier and cheap coffee to essentially disappear from supermarket shelves as the additional costs related to EUDR could erode their margins and force them to abandon the cheap price strategy that differentiated them in the market in the first place.

Dark chocolate: Could recipes by reformulated?

Chocolate products with high cocoa content will face challenges as added operational costs for cocoa-producing countries increase. This could lead some dark chocolate brands to reduce the amount of cocoa used in their products - so, a bar with 85% cocoa may drop to 80%. Alternatively, the products might simply be reduced in size leading to more ‘shrinkflation’. In terms of the added costs to importers that could result from the EUDR affecting cocoa, confidential industry sources report that cocoa which is compliant with the EUDR could carry a premium of $20-$30 per ton. These premiums would cover mapping and segregation costs, but not any remediation costs. It is highly likely that these costs will be at least partly passed onto the consumer in some form whether it be through price increases, or value engineering through reformulation or product size reduction.

Beef ‘leakage’: Could this be a possibility as European consumption is already slowing?

The EUDR covers beef, so the beef industry certainly faces the prospect of passing on additional costs to consumers, but that isn’t the critical concern.

There is reason to believe that Europe has already reached ‘peak meat.’ The population is flatlining and forecast to decline and health trends of the past decade are leading toward cuts in the consumption of red meat for many consumers. This gives rise to the prospect that the future of the meat market could lie in Asia, where rising populations, urbanization, and wages are allowing new consumer groups to afford different types of meat.

So, with European demand stagnant and incoming legislation adding further labor and administrative costs to imported meat, Europe runs the risk of businesses turning away from the EU and instead focusing on getting beef into China, a phenomenon known as ‘leakage’.[1]

Plant-based meat substitutes’: Sales outlook could worsen

Soy is used as a key source of protein for many plant-based meat alternative (PBMA) products. These products are most popular in North America and Western Europe, regions with high-income economies but stagnant real-terms wage growth for many consumers. The cost-of-living crisis in the UK, for example, has already resulted in a slowdown in demand for plant-based foods and out-of-home meals in restaurants. The UK and US have been among the countries leading the vegan boom in the Western world. However, in 2023 and 2024, vegan restaurants are starting to struggle.

Only 2% of consumers in the United States and 4% in the United Kingdom describe their diet as vegan[2], but that didn’t stop these countries from experiencing a huge surge in the popularity of vegan alternatives over recent years.

The one factor that made the boom in plant-based meat and dairy alternatives so valuable and a viable investment opportunity was that it was not limited to vegans. Without the participation of non-vegans, the vegan boom would have been impossible.

However, inflation in the UK and the US is mainly responsible for waning interest in the category. So, further price increases caused by the EUDR could worsen the slowdown in the consumption of plant-based foods.

Key take-outs

- The onset of these regulations could cause economic shocks, similar to China’s Zero COVID policy
- Supermarket staples like ground coffee, chocolate, beef, and cooking oil could all increase in price due to greenflation.
- The outlook for vegan and plant-based foods could worsen in the UK and US for a category already suffering from the knock-on effects of inflation and the cost-of-living crisis.

Source: [1] Science Direct- Forest Policy and Economics, Prospects and challenges for policy convergence between the EU and China to address imported deforestation; [2] GlobalData Consumer Survey Results Q1 2024

EU-China Relations

The EU's attempts to lead global policy direction also serves to widen the gap between its own requirements, and those of other major economic powers such as China.

Further divergence between the EU and China

In 2022, foreign direct investment from China into the EU reached an eight-year low[3]. In areas such as technology and AI, further barriers are being put up between the two trade blocs in response to national security concerns[2]. This has an impact beyond the technology sector. Complex relations between the EU and China see the two sides economically interlinked but highly cautious. China and the EU are in danger of further diverging on regulation with the onset of the EUDR and CSDDD.

As the world reverts to a multipolar global order, with China emerging as a major economic power with a large sphere of influence, relations between China and the US continue to worsen in many respects. The US has areas of contention with China, including the status of Taiwan, the role of Chinese tech companies in the US (e.g. TikTok), and trade and tariff issues, which came to prominence during the Trump administration's 'trade war' with China, which is still ongoing.

The strong alliance between the US and the EU means that European nations respond to US-China tensions by following the US's lead. In a future where relations worsen, the EU and its member states may put up added barriers between themselves and China in order to align with the US's strategy. The Trump presidential campaign is reportedly considering imposing a 60% tariff on Chinese goods in the event Trump wins the 2024 presidential election[1]. If this happens, US-China relations will inevitably worsen and may have knock-on effects on the EU-China relationship.

The actions of the EU and China, as well as the US, on deforestation will determine the extent to which the problem is tackled, as these two powers are two of the biggest importers of goods linked to 'forest risk.'

Stakeholders in the trade of goods linked to deforestation would benefit from convergent policy development between the EU and China, but this looks unlikely to happen any time soon.

The 'Brussels effect'

Coined in 2012 by a professor at Columbia Law School, the 'Brussels effect' describes the process of companies and countries outside of the EU adopting EU regulatory standards, not because they legally have to, but because of the impact the EU laws have on other market factors[2].

One could suggest that the EU's latest round of sustainability regulation aims to turn this 'effect' from a theoretical description into actual law by exerting power in the form of due diligence directives applicable to third-country organizations and backing them up with fines, threats of product and profit confiscation, and forced 'remedial action' for breaches.

However, the 'Brussels effect' seems to have little impact on China, which shows little intention of converging with EU legislation, instead focusing on further developing its own laws and standards on the issue.

Source: [1] Forbes- Trump's 60% Plan To Shock China Will Make Everyone Poorer; [2] Science Direct- Forest Policy and Economics, Prospects and challenges for policy convergence between the EU and China to address imported deforestation; [3] VOA- Analysts See New EU Rules Hurting China Exports, Further Straining Ties.

The Fear of 'Leakage' from the EU to China

The EU is using its size in an attempt to influence global regulatory policy, but while it is one of the most important markets in the global economy, it is not the only one.

The EU and China are the two top importers of commodities linked to deforestation

China is the world's largest importer of soy and beef. The EU is the world's largest importer of cocoa and palm oil[1].

Given the size of the EU and China markets, they can significantly impact the trajectory of these deforestation-linked industries. However, for this to be most effective, the strategy would need to be coordinated. Given China's current foreign policy, this is unlikely.

China's non-interference policy

China's foreign policy of non-interference means the country is highly unlikely to bring in the kind of laws the EU has enacted that impact companies outside of the EU. As China's role on the world stage continues to grow in significance, there is potential for the country to adopt regulations with direct impact across borders, like the EUDR. Still, it is difficult to predict if and when this would happen.

'Leakage'

In the event that the costs of EU sustainability regulation are deemed too high, a company may opt to sell its goods to China instead of the EU to avoid having to meet stringent EU standards. The sheer size of China's domestic consumer base means this is a real possibility, as companies in countries around the world know the significant size of the potential opportunities available in the Chinese domestic consumer market.

Unintended ecological consequences through land segmentation

Producers in Non-EU countries may decide to segment their land operations to cope with the demands of the EU.
It will likely make economic sense for producers of products covered by the EUDR to split their land and processing plants into 'EU-bound' and 'non-EU-bound' or 'China-bound' sections. That way, producers do not need to make the whole of their operation fit EU laws, but rather just the part that sends materials to the EU.

This would mark a departure from the established philosophy of trying to improve ecological outcomes overall, instead pushing farms and processing plants to improve only a small part of their operation at the expense of others.

Key take-outs

- EU regulations are widening the gap between the regulatory landscape of Europe and China.
- The 2024 US Presidential election will likely have big implications for US-China relations[1] and trade, and there will be significant knock-on effects for the EU and its member states.
- Producers in Africa and Asia may look to China to offload their products if EU regulation and legislation makes it too difficult to trade with the bloc.

Source: [1] Science Direct- Forest Policy and Economics, Prospects and challenges for policy convergence between the EU and China to address imported deforestation

Other Relevant Legislation and Potential Future Developments

Taxes on emissions may take the form of taxes on high-emission products, such as meat.

The likelihood of a tax on meat is growing

In February 2024, the German government released a policy proposal called ‘Animal Welfare Cent’ which calls for a tax on meat products.

A figure used quite a lot by proponents of a meat tax, including the German Green Party, who promote this measure, is that 15% of GhG methane emissions come from livestock[1]. This fact is the basis of the environmental argument for such a tax. There are also ethical and health arguments. Animal rights groups want the tax brought in to dissuade people from meat consumption on the basis that animals suffer as livestock. Health campaigners want it brought in on a similar basis to other ‘sin taxes’ such as taxes on tobacco, alcohol, and, more recently, sugar in soft drinks.

However, while there are some valid arguments for treating meat similarly to other unhealthy substances, several factors remain in the way. The fact is that meat production is vital to many developed nations’ economies. If Germany were to introduce a tax on pork, which is where the policy is likely to begin, it would impact German pork producers profoundly. The government is not unaware of this, and there are suggestions in the proposal and accompanying political documents for the revenue gained from a tax on pork to be reinvested into giving pigs in Germany larger pens. This would make the policy a positive for animal welfare, but recycling the funds into the pork industry would do little for the environment or consumers’ health.

In practical terms, if a meat tax is introduced but fails to decrease consumption, it has only contributed to food price inflation and generated some additional government revenue. If the tax succeeded in cutting net consumption of meat or certain meats, this would be financially damaging for the German meat industry. Either way, the proposed policy would appear to be heading for failure on both counts.

Despite this dilemma, the idea keeps gaining momentum. This is because passing such a tax would be proudly symbolic, marking a seismic shift in approach to the issue of greenhouse gas emissions and signalling to the rest of Europe and the world that Germany is leading the action on climate change. Despite practical barriers and questions around efficacy, politics could mean Germany implements a meat tax policy regardless.

Source: Reuters- EU launches first phase of world’s first carbon border tariff; [1] VAT Calc- Germany Meat Tax; Potsdam Institute for Climate Impact Research - Meat taxes can be designed to avoid overburdening low-income households

Most Relevant Regulation for Key Consumer and Foodservice Sectors

Most Relevant Regulation for Key Consumer and Foodservice Sectors

Relevant laws

EUDR

- All products derived from cattle will have to prove no links to deforestation.

CSDDD and CSRD

- Companies will need to provide data on carbon emissions of the whole value chain.
- Supplier companies from third countries will need to improve transparency and recording.
- From 2028, non-EU companies with high turnovers will need to submit sustainability reports to the EU.

CSDDD and CSRD

- Risk of fines for non-compliance.

Relevant laws

Circular Economy Action Plan

- Impact of packaging to come under further scrutiny.

Green Claims Directive

- Claims around packaging will be tightly monitored. 'Recyclable' claims must be more specific and must be backed by evidence. The EU will also make judgements on what can be omitted.

Relevant laws

EUDR

- Operational costs for cocoa suppliers will increase.
- The risk of sanctions for importers will become real.
- Smaller companies in the producer countries and in the EU may lose out to larger companies' ability to shoulder the cost of administration.
- Brands already meeting high sustainability standards may use their head start in the short term to increase market share.

CSDDD and CSRD

- Risk of fines for non-compliance.

Relevant laws

EUDR

- Expansion in the Soymilk production sector will become more difficult as demand grows for non-deforested land.

Green Claims Directive

- Soymilk products will not be able to make generic green claims, which could lead to the increased importance of third-party and government accreditations.

CSDDD and CSRD

- Risk of fines for non-compliance.

Note on Acronyms: EUDR- European Union Deforestation Regulation; CSDDD- Corporate Sustainability Due Diligence Directive; CSRD- Corporate Sustainability Reporting Directive

Most Relevant Regulation for Key Consumer and Foodservice Sectors

Relevant laws

EUDR

- Operational costs for coffee suppliers will increase.
- The risk of sanctions for importers will become real.
- The EUDR legislation does not currently cover soluble coffee, but the EU may subsequently decide to close this loophole.

CSDDD and CSRD

- Companies will need to provide data on carbon emissions of the whole value chain.
- Supplier companies from third countries will need to improve transparency and recording.
- From 2028, non-EU companies with high turnovers will need to submit sustainability reports to the EU.
- Risk of fines for non-compliance.

Relevant laws

EUDR

- Manufacturers may look to alternative protein sources as the Soy industry adjusts to new legislation and demand continues to grow.

Green Claims Directive

- Brands currently promoting themselves on vague environmental slogans and talking points may have to invest in proving these claims, or switch to a different marketing strategy.

Relevant laws

EUDR

- Disruption to oil palm industries in South-East Asia as governments take different approaches to addressing sustainability in oil palm products and their derivatives.
- Will likely see further ‘segmentation’ within farms between EU-bound and non-EU-bound operations.

Green Claims Directive

- Brands claiming to use ‘sustainable palm oil’ will have to ensure they are using the EU definition of sustainability.

CSDDD and CSRD

- Risk of fines for non-compliance.

Relevant laws

EUDR

- Soymilk will likely lose further ground to oat and rice milk as measures affect soy specifically.
- Further price increases for soymilk products may push the category further into the premium segment.

Green Claims Directive

- Brands will need to prove their soy milk is less impactful on emissions than cow’s milk in order to make these claims, instead of relying on common conceptions around plant-based milk.

Note on Acronyms: EUDR- European Union Deforestation Regulation; CSDDD- Corporate Sustainability Due Diligence Directive; CSRD- Corporate Sustainability Reporting Directive

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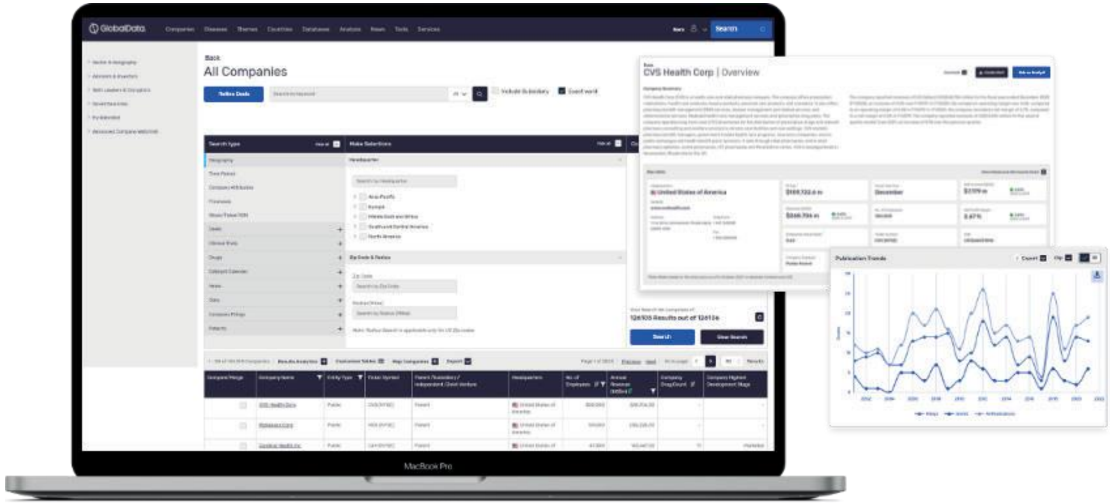

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Appendix

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Further Information

EU Definitions of Small, Medium, and Micro Enterprises [1]

Company category	Staff headcount	Turnover	Or	Balance sheet total
Medium-sized	< 250	≤ € 50 m		≤ € 43 m
Small	< 50	≤ € 10 m		≤ € 10 m
Micro	< 10	≤ € 2 m		≤ € 2 m

The EUDR compliance premium of US$1.5 billion for CPO, KPO and rubber is calculated as follows[2]:

Crude palm oil (CPO) is circa US$400 million
This assumes a CPO premium of $50-$100/mt which is in line with our understanding of current market values and based on EU consumption of 2.8 million tons in food, 0.5 million tons in oleochemicals, 0.8 million tons indirect uses, 1.4 million tons in biodiesel.

Palm kernel oil (PKO) is circa US$600 million
This assumes a PKO premium of $500-$600/mt which is in line with our understanding of current market values and based on EU consumption of 0.2 million tons in food, 0.4 million tons in oleochemicals and 0.5 million tons in indirect uses.

Rubber = US$540 million
This figure is based on confidential assumptions regarding market size and the EUDR premium for rubber.

Source: [1]https://single-market-economy.ec.europa.eu/smes/sme-definition_en [2] GlobalData Agribusiness Consultants
Note: All images in this whitepaper were sourced from Unsplash, Free Pixs and Envato Elements