Why smallholders must be favoured in the quest for traceability

Briefing for companies 2024

The Crux of Achieving Deforestation-Free Production under the European Deforestation Regulation

FORESTS OF THE WORLD.ORG

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Forests of the World is a Danish environmental organisation with more than 40 years of experience working with forest conservation in biodiversity hotspots in East Africa, South America and Central America. In Ethiopia and Uganda we work with local communities, smallholders and cooperatives to improve and expand agroforestry systems including cocoa, coffee and vanilla. We have been closely involved in the development process of the European Union Deforestation Regulation and are now testing traceability systems and working on ensuring implementation with our partners.

This briefing offers companies and other stakeholders insights into how traceability systems to ensure compliance with the European Union Deforestation Regulation should be designed to support smallholders and not leave anyone behind. The inclusion of smallholders and the consideration of their needs in relation to traceability is key to ensure achievement of the overall target of the regulation: to combat deforestation.

Introduction

The new European Union Deforestation Regulation (EUDR) is an ambitious initiative in the effort to halt global deforestation. Preventing deforestation and forest degradation is an important task in the context of climate change and declining biodiversity. The new regulation will require companies to prove that their products are deforestation-free and legally produced before placing it on the European market. The specific commodities covered by EUDR accounts for the vast majority of commodity-driven deforestation. These commodities are coffee, cocoa, soy, palm oil, rubber, wood and cattle.

The EUDR is a game changer and in particular the traceability requirement could revolutionise supply chain due diligence and create stronger, more transparent value chains free of deforestation. Companies across the EU are now looking for traceability systems that can ensure compliance with the EUDR and are simultaneously pushing the compliance requirements down through their supply chains. At the very beginning of these supply chains are smallholders, who do not have the resources to implement EUDR compliance nor traceability systems and are therefore at risk of being left behind. However, companies working with smallholders and who truly want to support the ambition of the EUDR, need to design their traceability system with smallholders in mind.

Therefore, Forests of the World recommend companies to choose and design their traceability systems following these seven requirements:

1. Designing for farmer cooperatives
2. Storing data close to source
3. Interoperability between systems
4. Simple and intuitive design
5. Fair business and financing models and reliable partners
6. Data premiums
7. Documentation needs to be based on local conditions and capacity

Right now, tools and systems for traceability are being developed by an array of actors, mostly for-profit. Importers and traders are pushing to implement these systems in their value chains, as they are to be held responsible for providing proof of no deforestation and will face the consequences if otherwise unable. One group that is not represented in the development of these systems, however, is smallholders, who make up the initial stage of the value chain pertaining especially coffee, cocoa, rubber and palm oil. They will, however, be required to provide the necessary data to buyers, in order to stay part of value chains ending up on the European market. This imposes a risk to small scale farmers as they risk loosing access to this market, if they cannot comply with the criterias. It could further marginalise this vulnerable group of people on the global market. In fact, the EUDR holds several concrete challenges for smallholders, as described in the next section.

Smallholders produce large shares of the targeted commodities globally (73% for coffee, 70% for cocoa, 85% for rubber, 35-40% for palm oil) and the commodities represent a major source of income for many smallholder households. Leaving these individuals to bear the biggest cost trickling down from the EU market would be counterproductive, considering that this could accelerate poverty driven deforestation - this especially concerns the forest-adjacent smallholders, who are also the ones most at risk of being left behind. Also, smallholders tend to be indirectly or directly forced to convert nature, in many cases causing deforestation due to a range of factors such as poverty, climate change and pressure from bigger players down the supply chain. Failing to include them could result in the loss of their potential positive impact, allowing for other markets with less demand for legal deforestation and degradation free products to take precedence.

To ensure that smallholders are not negatively impacted by the EUDR, the EU Commission shall engage in partnerships with producer countries (article 30 in the EUDR) to help them comply with the regulation – with special focus on assisting smallholders. The Commission is required to publish a strategy on this, however this is still pending. In the meantime the EU has presented a so-called Team Europe Initiative, which is centred on development initiatives and might become very relevant to ensure that producer countries can become EUDR compliant.

FACTBOX ON EUDR

- EUDR demands that all products made of/derived from the seven commodities placed on the EU market must be deforestation-free, wood must also be forest degradation-free, and comply with local legislation.
- Commodities covered: soy, palm oil, coffee, cocoa, timber, cattle and rubber.
- Cut-off date is 31. December 2020: No deforestation must have happened after this date in order to import/export the product.
- Operators and traders must provide proof of verification of no deforestation and legality. This includes traceability to the plot of land including polygon when the plot of land is larger than four hectares as well as additional information showing that no deforestation has occurred (satellite imagery could be one tool) and that the product is legally produced according to national law.
- EUDR enters into force on 30th of December 2024, 30th of June 2025 for small companies.

Risks posed to smallholders

The adaptive capacity among smallholders producing the mentioned commodities is often limited by access to capital and technical capacity. Without assistance, complying with European legislation will be difficult. At the same time, the EU can neither expect smallholders to engage in data sharing nor protect their own interests in the complex global value chains. Consequently, without assistance there is a great risk of further marginalisation of smallholders in international supply chains. This is indeed truly problematic, as the success of the EUDR in eliminating deforestation hinges on empowering smallholder communities with compliance solutions or viable alternatives that enable them to sustain themselves without resorting to clearing forest land.

CASE:
COFFEE COOPERATIVES IN WESTERN UGANDA

Uganda is a place well-suited for coffee, yet Ugandan coffee producers are earning only around 88 dollars per year from their coffee production, way below estimated living income. Often farmers are organised in cooperatives and cooperative unions to better access the international markets. However, these cooperatives often reside in poor facilities and with limited administrative or market capacity. The pictures below show a typical cooperative office, consisting only of a simple shed with producer names and coffee transaction records posted on the wall.

To prepare themselves better to deliver and manage the information required under the EUDR, the cooperatives will need technical support and an improved administrative infrastructure. Only very few cooperative members have access to smartphones or other digital equipment necessary for administration, let alone compliance with the new due diligence requirements in a digital manner.

Left picture: Records of coffee transactions on a wall in a cocoa cooperative in Western Uganda. Right picture: Forest-adjacent field in Western Uganda. Photo | Forests of the World

The main risks:

Based on FoW's assessment of the EUDR and smallholder communities, we have identified four main risks for smallholders.

Risk 1:
Shifting to other markets or producers

The primary risk associated with the EUDR is the potential decoupling of smallholder commodities from the EU market, compelling them to supply other markets with less strict import regulations. In such a scenario, the likelihood of preventing deforestation diminishes, and smallholders may struggle to earn a decent income.

One plausible outcome of this regulatory shift could be importers seeking to mitigate their compliance risks and associated costs by redirecting their sourcing to countries with lower risk profiles, thereby bypassing smallholders in high risk countries. Buyers within the EU might adopt a cautious approach towards engaging with smallholders, especially those operating in areas designated as high risk by the EU. Forest-adjacent smallholders, perceived as inherently riskier due to their proximity to forests, may face heightened reluctance from buyers. Given the prevailing uncertainty surrounding the implementation of the regulation, it is not improbable for European buyers to gravitate towards lower risk products and regions, a trend already observed among major buyers. Consequently, smallholders may be compelled to explore alternative markets to sell their goods unless support initiatives are established to overcome compliance issues.

This risk is further exacerbated if importers opt to collaborate with large-scale producers instead of smallholders. As the EUDR mandates traceability "down to plot of land", favouring producers with relatively larger land holdings, larger producers may enjoy a competitive advantage due to their ability to provide the requisite data per quantity and allocate resources to ensure compliance.

Risk 2:
Buyer lock-in and loss of bargaining power

Another significant risk stems from the potential for smallholders and cooperatives to become overly dependent on individual or specific buyers for access to the EU market. Many smallholders lack the technical capacity and tools necessary to generate and manage farm-related data, including the geolocation data required by the EUDR. Consequently, they may find themselves dependent on the capabilities of the buyers. Should this dependency materialise, transitioning from one buyer to another could prove challenging as this will necessitate a new data production process. This exacerbates the already limited bargaining power of the smallholders, leading to a scenario of buyer lock-in. In that way, smallholders find themselves tethered to specific buyers, unable to freely engage with the market.

Risk 3:
Unequal documentation requirements and risk perception

Companies importing goods into the EU are likely to prioritise compliance with the EUDR while seeking to minimise their costs. In the event that buyers do not shy away from smallholders overall, as outlined in the first scenario, there remains another distinct risk that they will still avoid forest-adjacent smallholders. This reluctance stems from the potential increase in documentation required to ensure compliance, particularly for smallholders operating in close proximity to forests.

For forest-adjacent smallholders, the EUDR could inadvertently impose an additional layer of documentation requirements, leading to uneven access to the European market. While all smallholders can suffice by providing just one GPS point for plots of land under four hectares and a polygon for plots of land larger than four hectares, forest-adjacent smallholders, regardless of their size, will find that polygons will be beneficial proving that they are truly deforestation-free, but adding costs and complexity to their due diligence systems. Consequently, companies could shy away from collaboration with forest-adjacent smallholders altogether due to the perceived risks related to production near forest boundaries. As a result, proving deforestation-free production in such a case becomes more tedious than simply relocating supply chains to forest-free areas.

Risk 4:
Additional costs of the EUDR being charged at farm level

The additional documentation required will inevitably incur an added cost, potentially burdening smallholders at farm level, as buyers may hesitate to pass these costs onto end-users, fearing loss of competitiveness in the market. While the EU has acknowledged the importance of fair pricing in the preamble to the EUDR, it is not explicitly mandated within the regulation itself, serving more as an encouragement than a requirement, such as paying a living income.

Furthermore, reliance on certifications schemes to ensure compliance poses a similar risk. Certification processes often entail substantial expenses and add an additional burden on the smallholders, exacerbating their financial challenges.

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Existing tools for traceability

EUDR compliance will require some kind of digital data management across different actors and countries due mostly to the traceability to plot of land requirement in the regulation, but also the additional information needed to prove legality and deforestation-free production. Currently, a variety of approaches and tools are being developed with differences regarding business model, ownership and organisation. Some of the main categories of digital data systems are described here:

Product-backwards digital tools: Many software developers offer traceability systems tailored for importers and traders. These are mostly designed to request, collect and manage EUDR relevant data from further down in the value-chain, as well as checking for deforestation and producing due diligence statements. The systems typically do not provide access to data for suppliers but merely rely on them to feed data into the system. These systems are typically developed by for-profit tech-companies and paid for by importers and traders. Examples are the systems provided by LiveEO, Meridia and Satelligence.

Source-forward digital tools: These systems are based on all or many of the value chain actors contributing to data production and management as the product moves forward. Data control is usually more decentralised. These systems can also be called *end-to-end traceability systems*. If value chain actors share the same platform, data sharing becomes easier. The problem with such systems is the limitations of the digital ecosystem. Farmers might manage their own data and choose different buyers, but only within the digital ecosystem. Examples are the systems from Farmer Connect and Iov42. The former finances itselves through the interactions on the platform. This system utilises blockchain.

Cooperative/SME management tools: These tools are also part of the current landscape of traceability solutions. As the name hints, they are limited to and only aimed at cooperatives or small scale farmers, and can give these entities the tools to produce traceability data and share it with buyers up the value chain. How well cooperative management systems contribute to EUDR compliance depends on their ability to share relevant data with other actors. As farmer cooperatives usually do not have large financial capital, funding is a barrier. Good examples are the systems provided by AgUnity, Litefarm and Farmforce.

One of the main challenges with the current landscape of digital systems is communication between systems. A data management system can create benefits for cooperatives and smallholder groups in itself, but to comply with the EUDR they must be able to share data with buyers.

Another major challenge is finding the right business model for these systems. Functioning digital systems require a lot of work in terms of both development, maintenance, training and support. Most smallholders and cooperatives do not have the financial capacities to invest in or subscribe to such systems, whereas this is possible for importers and traders, thus fostering smallholders to become involuntarily reliant on the data systems of their buyers.

Recommendations for traceability systems: Capabilities and sustainable design

To support the current value chains and business models of traders and importers working with smallholders, as well as avoiding the risks described, digital systems for traceability must have smallholder interests in mind. This means considering what capabilities the systems offer and how they are designed.

FoW recommends:

1. DESIGNING FOR FARMER COOPERATIVES

Many smallholders are not familiar with digital technologies or digital data management. Therefore, joining forces in cooperatives is the only realistic chance for the individual farmers to participate in data collection and administration. By participating at cooperative level, they can be stronger both financially and in terms of technical capacity. Therefore, it makes sense to design traceability tools such that they involve smallholders as groups. The link between the individual farmers and the cooperative does not have to be digital, but can rely on other methods of verification – for instance farmer cards with unique ID-codes, as introduced by Fairfood.

2. STORING DATA CLOSE TO SOURCE

Traceability systems should apply the principle of storing data as close to the source as possible. Accordingly, smallholders and cooperatives should have the ability to store and own farm-related data and use it for other purposes like cooperative management, certification, accessing loans and collaboration with service providers. This will limit the burden of repeated data collection and will provide benefits for farmers in terms of improved production, organisational transparency and possibly more.

3. INTEROPERABILITY

Traceability systems should be interoperable to allow easy data sharing.

4. SIMPLE AND INTUITIVE DESIGN

Digital tools targeting cooperatives and grower groups should be simple and intuitive in their design to accommodate low levels of technical capacity and literacy.

5. FAIR BUSINESS MODELS AND RELIABLE PARTNERS

Many smallholders need financial and organisational support – possibly even in the long term. Therefore, it is crucial to involve reliable partners such as the EU, local public institutions or international organisations in the operation, maintenance and development of digital systems for smallholders[1]. Ideally, the systems should be free of charge to the smallholders and rely on open source.

6. DATA PREMIUM

Traceability systems should facilitate monetization of data and data premiums for farmers. This requires the tracking of data sharing between actors.

7. DOCUMENTATION NEEDS TO BE BASED ON LOCAL CONDITIONS AND CAPACITY

The regulation asks for geolocation and legality. However, as mentioned above archiving and updating this documentation can be difficult, especially for smallholders. This also shows as archiving and updating documents is where most cooperatives fail in compliance of. e.g. voluntary certifications.

Hence, documentation of deeds on land, labour contracts, etc., pose a complication for smallholders who practise informal management. However, if verification and archiving could be made more accessible by applying easy to use systems and adapted formats or methodologies to prove compliance the inclusion of smallholders would become much easier.

It's important to distinguish between requirements adapted to smallholders' capacity and the requirements of large-scale producers, as their conditions and capacity differ. Also, exemption from conventional documentation should not mean exemption from documentation overall, but the provision of other but yet sufficient documentation of compliance. In the longer run this adaptation would mean that informality could become regularised and improve the position of smallholders in the EUDR compliant supply chain.

[1] FAO 2021: Farm data management, sharing and services for agriculture development, s. 24

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Conclusion

The EUDR has the potential to stop deforestation and redefine the way supply chains are managed. Together with other novel regulations and directives from the EU such as the Corporate Sustainable Reporting Directive and the Corporate Sustainable Due Diligence Directive, it sets the tone for compliance, and in the future data and due diligence will become a more integrated part of doing business - perhaps even companies' "licence to operate".

However, smallholders globally risk being left behind by the EUDR, which could lead to more deforestation, if not supported by all other stakeholders including companies, national governments, civil society as well as the EU and its members. Companies must keep smallholder providers in mind when designing and choosing the needed traceability system, while governments, the EU and member states must support smallholders with the funding and tools to comply.

If companies are able to include smallholders and consider solutions that do not leave behind small-scale farmers or put unnecessary financial and administrative burdens on them, we could succeed in halting deforestation and provide more and better opportunities for local communities.

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